Supreme Court, U.S.
FILED

011602 APR 24 2002

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No. 01-

IN THE

Supreme Court of the United States

NEW YORK STOCK EXCHANGE, INC.,

Petitioner,

v.

MFS SECURITIES CORPORATION
and MARCO SAVARESE,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Did the Court of Appeals err in vacating the dismissal of respondents' claims under Section 1 of the Sherman Act (15 U.S.C. § 1), where the Complaint alleges no harm to competition, and the per se rule does not apply because the group boycott asserted here (a) involved the regulation by a national securities exchange of its membership pursuant to its statutory self-regulatory mandate, and (b) did not involve conduct that would "always or almost always" harm competition or was an effort to disadvantage a competitor?

2. Did the Court of Appeals err in invoking the doctrine of primary jurisdiction to allow the Securities and Exchange Commission to consider issues of procedural fairness under the Securities Exchange Act of 1934 (15 U.S.C. § 78a *et seq.*), where no possible SEC determination of those procedural issues could avoid the conclusion that the Complaint fails to allege facts showing the harm to competition necessary to state a claim under Section 1 of the Sherman Act?

LIST OF PARTIES AND CORPORATE DISCLOSURE STATEMENT

The caption of the case lists all parties to the proceeding. Petitioner New York Stock Exchange, Inc. ("NYSE" or "Exchange") has no parent corporations and does not have any issued stock.

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CITATION TO OPINIONS BELOW

The opinion of the United States Court of Appeals for the Second Circuit is reported at 277 F.3d 613 (2d Cir. 2002), and is reproduced in Appendix ("App.") A hereto. The unreported memorandum order of the United States District Court for the Southern District of New York granting NYSE's motion to dismiss under Fed. R. Civ. P. 12(b)(6) is available at 2001 U.S. Dist. LEXIS 420 (S.D.N.Y. Jan. 23, 2001), and is reproduced at App. B.

STATEMENT OF JURISDICTION

The Court of Appeals entered judgment on January 24, 2002. This Court's jurisdiction rests on 28 U.S.C. § 1254(1).

STATUTES AND RULES INVOLVED

Relevant provisions listed below (please see App. for text):

1. Sherman Act, Section 1 (15 U.S.C. § 1) (App. E at 76a).

2. Securities Exchange Act of 1934 (15 U.S.C. § 78a *et seq.*)

   (a) Section 3(a)(26) (15 U.S.C. § 78c(a)(26)) (App. E at 76a);

   (b) Section 6(b) (15 U.S.C. § 78f(b)) (App. E at 77a-82a);

   (c) Sections 19(d), (g) (15 U.S.C. §§ 78s(d), (g)) (App. E at 82a-85a).

3. Constitution of New York Stock Exchange, Inc. (App. F):

   (a) Art. I, Sections 3(i) and (k) (App. F at 86a);

   (b) Art. IV, Section 14 (App. F at 87a).

STATEMENT OF THE CASE[1]

Petitioner New York Stock Exchange, Inc. ("NYSE"), defendant below, is a national securities exchange registered by the Securities and Exchange Commission ("SEC" or "Commission") under Section 6 of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78f, and a self-regulatory organization under Section 3(a)(26) of the Exchange Act, 15 U.S.C. § 78c(a)(26). *See* Complaint, dated July 27, 2000 (hereafter, "Complaint"), ¶ 12 (App. D at 27a).

As a self-regulatory organization, NYSE has a duty to promulgate and enforce rules governing Exchange membership and the conduct of members and member organizations. 15 U.S.C. §§ 78f(b), 78s(g). *See Silver v. New York Stock Exchange*, 373 U.S. 341, 353 (1963) ("One aspect of the statutorily imposed duty of self-regulation is the obligation to formulate rules governing the conduct of exchange members."); *Barbara v. New York Stock Exchange, Inc.*, 99 F.3d 49, 51 (2d Cir. 1996) ("[T]he Exchange is a

1. The "facts" discussed in this Petition are those alleged in the Complaint (App. D), which are deemed true solely for purposes of NYSE's Rule 12(b)(6) motion and review thereof. *See Hishon v. King & Spalding*, 467 U.S. 69, 73 (1984). NYSE does not in this Petition concede the truth of any of the allegations of the Complaint. In addition, NYSE is entitled to rely on respondents' concession in open court described *infra* at 4, n.3.

'self-regulatory organization' which means that it has a duty to promulgate and enforce rules governing the conduct of its members.") (citations omitted).

Respondent MFS Securities Corp. ("MFS"), a plaintiff below, was a corporation engaged in the securities business. Complaint, ¶ 2 (App. D at 24a). Until February 25, 1998, MFS was an NYSE member organization doing business as a broker-dealer in registered securities. Complaint, ¶¶ 1, 2 (App. D at 23a-24a). Respondent Marco Savarese, also a plaintiff below, is the president and sole shareholder of MFS. Complaint, ¶ 3 (App. D at 25a). MFS' only NYSE members were his sons, Mark Savarese and John Savarese, who worked for MFS as floor brokers, also known as "$2 brokers." Complaint, ¶¶ 4, 5, 13, 14 (App. D at 25a, 27a-29a). Respondents allege that there are approximately 500 floor brokers trading on NYSE. Complaint, ¶ 14 (App. D at 28a-29a).

According to the Complaint, in the 1990s various floor brokers violated the Exchange Act by "flipping" securities in connection with accounts in which they held an interest. Complaint, ¶ 26-31 (App. D at 32a-35a). The Complaint alleges that NYSE violated the Exchange Act by condoning and encouraging this practice. Complaint, ¶¶ 25, 27, 30 (App. D at 31a-34a).

Mark and John Savarese engaged in such conduct beginning in 1993, and continued to do so for over four years. Complaint, ¶¶ 71, 74 (App. D at 55a, 56a). On February 25, 1998, they were arrested and indicted for alleged violations of the federal securities laws, and sued by the Securities Exchange Commission (the "SEC"). Complaint, ¶¶ 80, 82, 84 (App. D at 60a, 61a). They subsequently pled guilty to criminal charges. Complaint, ¶ 82 (App. D at 61a).

Also on February 25, 1998, NYSE summarily suspended John and Mark Savarese from NYSE membership. Complaint, ¶¶ 74, 81 (App. D at 56a, 61a). The Complaint alleges that NYSE then declared MFS' status as an NYSE member organization "automatically terminated," and cut MFS' phone lines on the NYSE floor. Complaint, ¶ 91 (App. D at 66a).[2] The Complaint further alleges that NYSE "terminated" MFS without notice or opportunity for hearing, and thereby violated the Exchange Act and NYSE Rules. Complaint, ¶¶ 91-92, 95-96. (App. D at 66a-68a).[3]

On July 27, 2000, respondents sued NYSE in the United States District Court for the Southern District of New York, alleging that NYSE's actions (1) were in breach of contract, and (2) constituted a conspiracy in unreasonable restraint of trade, and, particularly, a group boycott, in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1. App. E at 76a. The Complaint does not allege any facts showing that NYSE's claimed conduct raised prices, harmed output, or otherwise

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2. Lacking any NYSE members as officers or employees, MFS automatically ceased to qualify as an NYSE member organization. *See* NYSE Constitution, Article I, Sections 3(i) and (k) (NYSE "member organization" must have at least one officer or employee who is an NYSE member). App. F at 86a.

3. At oral argument on NYSE's motion to dismiss, respondents conceded that MFS did in fact receive a hearing before the Committee for Review of the Board of Directors of NYSE. *See* App. C (Extracts from transcript of hearing, November 28, 2000) ("[S]ome weeks after MFS was terminated .... a proceeding .... occurred before a committee of the board of directors of the New York Stock Exchange."). *See* Article IV, Section 14 of the NYSE Constitution. (*See* App. F at 87a) (a "member organization . . . affected by a decision of any officer, employee or committee acting under powers delegated by the Board may require a review by the Board of that decision. . . .")

harmed competition in any market. Indeed, the Complaint does not purport to define any relevant market.

The only alleged conspirators identified in the Complaint are NYSE and certain NYSE employees. Complaint, ¶ 6-10 (App. D at 25a-26a). Respondents do not claim that these persons "terminated" MFS' membership to exclude any competitor from a market; rather, they claim that the asserted "termination" was intended to "curry favor" with government agencies and conceal NYSE's alleged violation of the Exchange Act. Complaint, ¶ 1. (App. D at 23a-24a). *See also* Complaint, ¶¶ 80, 89, 92, 96 (App. D at 60a, 63a-64a, 66a, 68a).

NYSE moved to dismiss the Complaint under Fed. R. Civ. P. 12(b)(6) on several grounds. In a memorandum order dated January 22, 2001, the District Court (Rakoff, J.) granted the motion as to all claims. App. B. With respect to the Sherman Act claims, the District Court determined that the rule of reason, rather than the per se rule, applies in this case, because the alleged boycott involved the "statutorily imposed 'anticompetitive' obligations of a self regulating securities exchange. . . to define and limit membership and enforce Exchange rules against members . . . ," citing *Silver*, 373 U.S. at 360. App. B at 20a. Because the Complaint "failed to allege any anticompetitive effect whatsoever," the District Court held that it did not state a claim under the rule of reason. App. B at 20a.

Respondents appealed to the United States Court of Appeals for the Second Circuit. That court affirmed the dismissal of the contract claim. App. A at 8a. However, it *sua sponte* invoked the doctrine of primary jurisdiction and vacated the dismissal of the Sherman Act claim with directions that the District Court stay further proceedings

until such time as the SEC may have acted on a promptly-filed application for review. App. A at 18a. The Court of Appeals did not find any error in the District Court's dismissal of the antitrust claim, but deferred decision of the matter, suggesting that the SEC could provide "material aid" to the District Court by considering "whether [MFS'] membership revocation contravened the [Exchange] Act and the rules. . . ." App. A at 13a, 15a. The Court of Appeals stated that the SEC's consideration of "whether a procedural deficiency [existed] under the Exchange Act" would assist the District Court in determining, *inter alia*, "whether, if a possible antitrust contravention exists, the proper Sherman Act examination is that provided by a per se or a rule of reason analysis." App. A at 16a.[4]

REASONS FOR GRANTING THE WRIT

I. SUMMARY OF ARGUMENT.

This case warrants review on certiorari under Supreme Court Rule 10(c) because the Court of Appeals decided a significant federal issue in a manner that conflicts with this Court's decisions, including *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963), and *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284 (1985).

As the District Court recognized (App. B at 20a), these proceedings should be dismissed because respondents have failed to allege any actual harm to competition, a necessary element for a rule of reason violation of Section 1 of the

4. NYSE sought dismissal on several grounds below, but this Petition seeks certiorari only with respect to the issue of whether the Complaint adequately pleads the "injury to competition" that is necessary for a claim under Section 1 of the Sherman Act.

Sherman Act, and the per se rule does not apply as a matter of law. *See* Part II, *infra*.

In an ongoing series of pronouncements, this Court has emphasized that the per se rule applies only in limited situations (*see* Part II. A, *infra*), which do not exist here. As the Court in *Silver* held, the conduct of a national securities exchange, acting as a self-regulatory organization under the Exchange Act, must be assessed under the rule of reason in order to allow it "sufficient breathing space within which to carry to carry out the mandate of the Securities Exchange Act." 373 U.S. at 360. The decision of the Court of Appeals conflicts with this principle, since the "automatic termination" of MFS' membership status alleged here falls squarely within NYSE's self-regulatory responsibility. *See Silver*, 373 U.S. at 360 (referring to the "entire public policy of self-regulation, beginning with the idea that the Exchange may set up barriers to membership. . . .") *See* Part II. B, *infra*.

Moreover, as this Court held in *Northwest Wholesale Stationers*, a plaintiff seeking to invoke the per se rule as to an alleged group boycott "must present a threshold case that the challenged activity falls into a category likely to have predominantly anticompetitive effects. . . . because not all concerted refusals to deal are predominantly anticompetitive." 472 U.S. at 298. The issue of whether to apply the per se rule turns on "whether the practice facially appears to be one that would always or almost always tend to restrict competition and decrease output. . . ." *Id.* at 289-90, *quoting Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1, 19-20 (1979). In addition, a per se unlawful group boycott claim generally "involve[s] joint efforts by a firm or firms to disadvantage

competitors. . . ." 472 U.S. at 294. Respondents have not alleged facts showing that the claimed conduct had any anticompetitive effect at all, much less that it would "always or almost always" have such impact. Nor have they alleged any facts showing that the purpose of the claimed "termination" of MFS was to "disadvantage competitors." *Northwest Wholesale Stationers*, 472 U.S. at 294. *See* Part II. C, *infra*.

In these circumstances, the Court of Appeals improperly invoked the doctrine of primary jurisdiction. The court thought the District Court's Sherman Act analysis could benefit from SEC consideration of whether the procedure afforded MFS complied with the Exchange Act. However, no SEC decision on that issue could support the application of the per se rule here. Indeed, the Court of Appeals' approach directly conflicts with this Court's decision in *Northwest Wholesale Stationers*, which held that:

> [T]he absence of procedural safeguards can in no sense determine the antitrust analysis. If the challenged concerted activity of Northwest's members would amount to a *per se* violation of § 1 of the Sherman Act, no amount of procedural protection would save it. If the challenged action would not amount to a violation of § 1, *no lack of procedural protections would convert it into a per se violation*. . . .

472 U.S. at 293 (emphasis added).

This Court has established that primary jurisdiction does not apply where agency consideration would be futile and result in "an expensive and merely delaying administrative proceeding." *See Amalgamated Meat Cutters & Butcher*

Workmen v. Jewel Tea Co., 381 U.S. 676, 686 (1965) (citation omitted). The decision below is flatly inconsistent with that principle. *See* Part III, *infra*.

II. THE DECISION OF THE COURT OF APPEALS CONFLICTS WITH CONTROLLING SUPREME COURT PRECEDENT, WHICH ESTABLISHES THAT THE PER SE RULE DOES NOT APPLY TO THE ANTITRUST CLAIM HERE REGARDLESS OF THE SEC'S VIEW OF THE PROCEDURAL PROPRIETY OF THE ALLEGED CONDUCT.

To support a claim under Section 1 of the Sherman Act, a plaintiff must plead facts showing that the challenged action has harmed competition.[5] Plaintiff may seek to satisfy this burden under the rule of reason, which requires actual anticompetitive effects in a relevant market,[6] or the per se

5. *State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997) (only unreasonable restraints of trade are prohibited under the Sherman Act); *National Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 690 (1978) (conduct cognizable under Section 1 only if it has an "impact on competitive conditions"); *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977) (the purpose of the antitrust laws is to protect competition).

6. *See, e.g.*, *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 768 (1984) (rule of reason analysis requires "an inquiry into market power and market structure designed to assess the combination's actual effect."); *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 45, 53 n.21 (1977) (effect of restraint must be considered "in light of the competitive situation in the product market as a whole").

A truncated rule of reason analysis, also called "the quick look doctrine," may be applied "when the great likelihood of (Cont'd)

rule, which conclusively presumes such effects under limited circumstances.[7]

Plaintiffs have alleged no facts showing that the claimed "termination" of MFS as a member organization caused any actual injury to competition, as is necessary under the rule of reason. *See* App. B at 20a. (District Court holding that respondents have "failed to allege any anticompetitive effect whatsoever.")

To the contrary, the Complaint concedes that there are approximately 500 floor brokers trading on NYSE, making it impossible to conclude that the "termination" of just one member organization, without any qualifying members, could possibly result in higher prices, reduced output, or other harm to competition in any market. *See National Collegiate Athletic Ass'n v. Bd. of Regents of the University of Oklahoma*, 468 U.S. 85, 109-10 (1984) (focusing on price and output impact of claimed restraint).[8] Indeed, the

(Cont'd)
anticompetitive effects can easily be ascertained." *California Dental Ass'n v. FTC*, 526 U.S. 756, 770 (1999). The quick-look doctrine does not apply here, where there is no allegation suggesting any harm to competition whatsoever. Nor could there be any such harm from the alleged "termination" of one member organization where there are approximately 500 NYSE floor brokers. *See* discussion *infra* at 10.

7. *See, e.g., United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 225, n.9 (1940) (naked agreements among competitors to set or stabilize prices are illegal per se); *Palmer v. BRG of Ga., Inc.*, 498 U.S. 46, 49-50 (1990) (naked horizontal market allocation is illegal per se).

8. Merely pleading that an individual competitor has been excluded is insufficient to show harm to competition. *See NYNEX v.*
(Cont'd)

Complaint does not even attempt to identify any market in which competition allegedly was harmed.[9]

Thus, plaintiffs' only hope of pleading a Section 1 claim is to seek invocation of the conclusive presumption of injury to competition contained in the per se rule. *See Northern Pac. Ry v. United States*, 356 U.S. 1, 5 (1958). However, per se analysis is inapplicable here under both *Silver* and *Northwest Wholesale Stationers*. The Court of Appeals erred in not affirming the District Court's dismissal, and instead seeking SEC input on procedural issues under the Exchange Act that, regardless of the SEC's conclusion, could not result in application of the per se rule to this case.

A. The Per Se Rule Applies Only In Narrow Circumstances.

This Court repeatedly has declared that the per se rule applies only in quite limited circumstances. *See, e.g., Continental TV, Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 49 (1977) (per se rule is the exception to the rule of reason). Agreements should be considered per se illegal, if, and only if, "considerable experience" with the business relationship

(Cont'd)
Discon, Inc., 525 U.S. 128, 139 (1998) (allegation that one firm was harmed "does not automatically show injury to competition"); *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 31 (1984) (rule of reason claim arising out of exclusion of just one anesthesiologist at hospital did not prove any adverse effect on competition in market as a whole).

9. *GTE Sylvania, Inc.*, 433 U.S. at 53 n.21 ("[A]n antitrust policy divorced from market considerations would lack any objective benchmarks.").

at issue[10] demonstrates that it has a "pernicious effect on competition," lacks "any redeeming virtue,"[11] and will "always or almost always tend to restrict competition and decrease output. . . ." *Northwest Wholesale Stationers*, 472 U.S. at 289-90, *quoting BMI*, 441 U.S. at 19-20; *see also Khan*, 533 U.S. at 10 (most antitrust claims are considered under rule of reason; the Court is reluctant to apply per se rule where adverse economic effect not immediately obvious).

Respondents' claim of per se liability is based solely on a group boycott theory. However, this Court has held that group boycotts do not automatically trigger the per se rule. *See, e.g., Northwest Wholesale Stationers*, 472 U.S. at 295. Indeed, in *FTC v. Indiana Fed. of Dentists*, 476 U.S. 447 (1986), the Court declared that the per se rule only applies to group boycotts in exceptional cases, and "is not to be expanded indiscriminately. . . ." *Id.* at 458. As explained in Parts II.B & C, *infra*, this is not a case to which that per se rule may be applied.

B. The Court In *Silver* Held That The Per Se Rule Does Not Apply To A Securities Exchange's Regulation Of Its Membership Pursuant To Its Statutory Self-Regulatory Mandate.

In *Silver*, plaintiffs traded municipal bonds. They were not members of NYSE, and relied on private wire access to facilitate instantaneous communications with exchange

10. *White Motor Co. v. United States*, 372 U.S. 253, 261 (1963). The Complaint asserts that the courts do not have considerable experience with the conduct at issue here, alleging that the claimed "termination" here is unique in NYSE's history. Complaint, ¶ 108. (App. D at 71a).

11. *Northern Pac. Ry*, 356 U.S. at 5.

members. Without prior notice to plaintiffs, NYSE disapproved the private wire connections between member and non-member firms, and required the former to terminate those connections.

This Court stated that, under the law at the time,[12] defendant's action would have constituted a per se illegal group boycott under Section 1 of the Sherman Act had it not involved self-regulatory activity by NYSE. 373 U.S. at 360. The Court recognized, however, that the very concept of self-regulation under the Exchange Act may require an exchange to engage in "anticompetitive" conduct with regard to membership:

> The entire public policy of self-regulation, beginning with the idea that the Exchange may set up barriers to membership, contemplates that the Exchange will engage in restraints of trade which might well be unreasonable absent sanction by the Securities Exchange Act.

Silver, 373 U.S. at 360.

As a result, the Court applied the rule of reason to the conduct at issue, in order to provide NYSE with "sufficient breathing space within which to carry to carry

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12. In 1963, "group boycotts" generally were considered per se illegal under the antitrust laws. *See, e.g., Klor's, Inc. v. Broadway-Hale Stores, Inc.*, 359 U.S. 207 (1959); *United States v. General Motors Corp.*, 384 U.S. 127 (1966)). The application of the per se rule to such conduct is now, however, governed by this Court's subsequent decisions in *Northwest Wholesale Stationers*, 472 U.S. at 295, and *Indiana Fed. of Dentists*, 476 U.S. at 459. *See also BMI*, 441 U.S. at 19-20. *See* Part II. C, *infra*.

out the mandate of the Securities Exchange Act." 373 U.S. at 360; *see also Jacobi v. Bache & Co.*, 520 F.2d 1231, 1238 (2d Cir. 1975), *cert. denied*, 423 U.S. 1053 (1976) (quoting *Silver* extensively, and explaining that "within the area of supervised self-regulation contemplated by the Securities Exchange Act, *per se* concepts are generally displaced and the courts are to examine whether the particular restraint, even though it would be a *per se* violation if performed by others, was reasonable.").

Here, NYSE's asserted action involves the summary suspension of MFS' only member-employees when they were criminally indicted and sued by the SEC for alleged securities law violations, and the consequent disqualification of MFS' status as a member organization. *See* NYSE Constitution, Article I, Sections 3(i) and (k) (App. F at 86a); p. 4 n.2, *supra*.

Such claimed conduct is at the very heart of NYSE's self-regulatory mandate "to compel . . . and enforce compliance by its members and persons associated with its members" with the Exchange Act. Exchange Act § 6(b)(1), 15 U.S.C. § 78f(1) App. E at 78a; *see also* Exchange Act § 6(b)(5), 15 U.S.C. § 78f(b)(5) (rules of exchange must be designed to "prevent fraudulent and manipulative acts and practices") App. E at 78a-79a; Exchange Act § 6(b)(6), 15 U.S.C. § 78f(b)(6) (exchange rules must provide for members [such as Mark and John Savarese] . . . to be disciplined for violating provisions of the Exchange Act, by expulsion, suspension, or by limitation of their activities, functions and operations) App. E at 79a; Exchange Act § 6(b)(7), 15 U.S.C. § 78f(b)(7) (exchange rules must "provide a fair procedure for the prohibition or limitation by the exchange of any person with respect to access to services offered by the exchange or a member thereof.") App. E at 79a-80a. As the District Court held, citing *Silver*, it is precisely because of the "statutorily imposed 'anticompetitive' obligations of a self-

regulating securities exchange under the Securities Exchange Act to define and limit its membership" that courts have "mandate[d] application of the 'rule of reason,' rather than a per se analysis," even when the challenged conduct otherwise might warrant per se treatment. App. B at 20a.

Thus, NYSE's alleged action here may not be evaluated under the per se rule. *Silver*, 373 U.S. at 360-361.

C. The Court In *Northwest Wholesale Stationers* Held That The Per Se Rule Regarding Group Boycotts Does Not Apply To Conduct That Is Not Always Or Almost Always Anticompetive.

In *Northwest Wholesale Stationers*, defendant was a wholesale buying cooperative comprised of numerous retailers. The members of the cooperative voted to expel the plaintiff. Plaintiff claimed that this termination constituted a per se unlawful violation of Section 1, but this Court disagreed.

Articulating the law in this area (472 U.S. at 289-291), the Court held that alleged group boycotts may have competitive benefits, and therefore are not necessarily considered under the per se rule. *See id.* at 295-98. Indeed, the per se rule does not apply unless the challenged practice "always or almost always tend[s] to restrict competition. . . ." *Id.* at 289-90. The Court also emphasized that "[c]ases to which this Court has applied the per se approach have generally involved joint efforts by a firm or firms to disadvantage competitors. . . ." *Id.* at 294. *See also Indiana Fed. of Dentists*, 476 U.S. at 459 (per se approach has been applied to group boycotts in limited cases, and "is not to be expanded indiscriminately. . . .")

The *Northwest Wholesale Stationers* Court added:

> The act of expulsion from a wholesale cooperative does not necessarily imply anticompetitive animus and therefore raise a probability of anticompetitive effect. Wholesale purchasing cooperatives must establish and enforce reasonable rules in order to function effectively.

472 U.S. at 296-297 (citation omitted).

Here, the Complaint does not allege any facts showing that the claimed "termination" of one member organization — where there are asserted to be approximately 500 floor brokers — could ever injure competition, much less "always or almost always" do so. Nor does the Complaint allege that the claimed "termination" of MFS' status as a member organization resulted from any effort to "disadvantage competitors," or from any "anticompetitive animus" at all. The Complaint alleges that NYSE and its specified employees engaged in this asserted conduct to "curry favor" with government agencies and conceal NYSE's alleged violation of the securities laws, not for the purpose of harming competition.

Thus, NYSE's alleged action here may not be evaluated under the per se rule.

III. THE COURT OF APPEALS ERRED IN INVOKING THE DOCTRINE OF PRIMARY JURISDICTION WHERE THE PER SE RULE WOULD NOT APPLY TO THIS CASE REGARDLESS OF THE SEC'S VIEW OF THE PROCEDURAL ISSUES DESCRIBED BY THE COURT.

Rather than deciding whether the Complaint states a Sherman Act claim, the Court of Appeals deferred the issue by invoking the doctrine of primary jurisdiction. It suggested that the SEC's consideration, under the Exchange Act, of the adequacy of the process afforded to respondents would be of "material aid" to the District Court in resolving the Sherman Act claim. This was error. As a matter of law, the SEC cannot provide the court with any assistance on the question of the application of the per se rule here.

The doctrine of primary jurisdiction permits a court to refer a matter extending beyond the "conventional experiences of judges," or "falling within the realm of administrative discretion," to an administrative agency whose specialized experience may help resolve technical and intricate questions of fact and policy. *Nader v. Allegheny Airlines, Inc.*, 426 U.S. 290, 303-04 (1976); *Far East Conference v. United States*, 342 U.S. 570, 574 (1952).

As discussed above, dispositive precedent of this Court mandates that the per se rule of antitrust law does not apply here, regardless of the SEC's view of procedural compliance with the Exchange Act.[13] In *Northwest Wholesale Stationers*,

13. In *Silver*, the Court held NYSE's conduct unreasonable under the rule of reason where (1) at that time, the conduct would (Cont'd)

defendant had afforded plaintiff "neither notice, nor hearing, nor any other opportunity to challenge" the members' decision to expel it from the buying cooperative. 472 U.S. at 287. The Court of Appeals applied the per se rule to plaintiff's claim; it believed that the rule of reason could govern the challenged termination only if defendant had provided sufficient procedural safeguards, and held that defendant had not done so. 715 F.2d 1393, 1396-98 (9th Cir. 1983).

This Court rejected that conclusion — and thus the holding of the Court of Appeals in this case. The Court declared that the adequacy of procedural protections was legally irrelevant to the application of the per se rule:

> [T]he absence of procedural safeguards can in no sense determine the antitrust analysis. If the challenged concerted activity of Northwest's members would amount to a *per se* violation of § 1 of the Sherman Act, no amount of procedural protection would save it. If the challenged action

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(Cont'd)
have been unlawful per se had it not been that of self-regulatory organization under the Exchange Act, and (2) NYSE had offered plaintiffs no hearing. *See* 373 U.S. at 360-62. In light of this Court's decisions in *Northwest Wholesale Stationers*, 472 U.S. at 295-98, and *Indiana Fed. of Dentists*, 476 U.S. at 459, the first basis for that decision no longer applies. *See* discussion *supra* in Part II. C. Moreover, in contrast to the situation of the plaintiffs in *Silver*, where plaintiffs had no hearing, respondents here have conceded that they were afforded a hearing by a committee of the NYSE Board. *See* App.C at 22a. Indeed, the Court in *Silver* specifically distinguished the situation of the non-member plaintiffs there from that of members, who have a right of review under Art. IV, Section 14 of the NYSE Constitution. *Silver*, 373 at 363, n.15. *See* App. F at 87a.

> would not amount to a violation of § 1, no lack of procedural protections would convert it into a per se violation. . . .

472 U.S. at 293. Thus, any consideration by the SEC of whether or not NYSE's conduct here was procedurally adequate under the Exchange Act could not inform the court's decision as to the applicability of the per se rule.

In invoking the doctrine of primary jurisdiction, the Court of Appeals relied on the decision in *Ricci v. Chicago Mercantile Exchange*, 409 U.S. 289 (1973). App. A at 13a-15a. In that case, the referral to the Commodity Exchange Commission related to the question of the applicability the doctrine of implied repeal, not to the question of whether the per se rule or the rule of reason applies. Since the SEC cannot be of any aid as to the latter question here, and (as the District Court held) the only appropriate answer to that question requires dismissal of the Complaint,[14] the Court of Appeals' reference to the SEC was inappropriate. As this Court stated in *Amalgamated Meat Cutters & Butcher Workmen v. Jewel Tea Co.*:

> [T]he doctrine of primary jurisdiction is not a doctrine of futility; it does not require resort to an expensive and merely delaying administrative proceeding when the case must eventually be decided on a controlling legal issue wholly unrelated to determinations for the ascertainment of which the proceeding was sent to the agency.

381 U.S. at 686 (citation omitted).

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14. Because the application of the rule of reason is dispositive of the case, it is irrelevant to this Petition whether or not the SEC's expertise might help resolve any of the other grounds for dismissal that NYSE raised below.

CONCLUSION

The Court should grant the Petition for a Writ of Certiorari.

Respectfully submitted,

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April 24, 2002

APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DATED AND DECIDED JANUARY 24, 2002

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

August Term, 2001

(Argued: September 5, 2001 Decided: January 24, 2002)

Docket No. 01-7137

MFS SECURITIES CORP. and MARCO SAVARESE,

Plaintiffs-Appellants,

—v.—

NEW YORK STOCK EXCHANGE, INC.,

Defendant-Appellee.

Before:

NEWMAN, CALABRESI, and SACK,

Circuit Judges.

Appeal from a judgment of the United States District Court for the Southern District of New York (Jed S. Rakoff, *Judge*), granting defendant's motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6) and dismissing the complaint in a suit arising from the termination of plaintiff MFS Securities Corp.'s membership on the New York Stock Exchange.

Appendix A

Affirmed in part, vacated and remanded in part, with directions.

* * *

CALABRESI, *Circuit Judge:*

Plaintiffs MFS Securities Corp. and Marco Savarese (collectively, "MFS" or "appellants") appeal from a judgment of the United States District Court for the Southern District of New York (Jed S. Rakoff, *Judge*) dismissing MFS's suit, which alleged (1) that defendant New York Stock Exchange (the "NYSE" or the "Exchange") had participated in a group boycott in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1, and (2) that the NYSE had breached its membership contract with MFS. The district court granted defendant's motion to dismiss under Fed. R. Civ. P. 12(b)(6). We affirm in part, and vacate and remand in part, with directions.

BACKGROUND

In the 1990s, floor brokers on the NYSE participated in a trading practice known as stock "flipping." Flipping stocks, also known as "trading for eights," involves the purchase or sale of a security for a customer followed by the sale or purchase of the same security for a profit of one-eighth of a point, the then-spread between the bid and ask prices. Through this practice, the floor broker for the transaction not only received a commission for the trade but also obtained profits, which were typically shared with the customer. In 1993, two MFS Securities Corp. floor brokers, Mark Savarese and John Savarese, sons of plaintiff Marco Savarese, began flipping stocks.

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According to MFS, the NYSE was aware, as early as 1991, that floor brokers participated in flipping stocks and were sharing in the resulting profits gained by their customers. MFS alleged that the NYSE supported and encouraged this activity, both because it increased daily trading volume on the NYSE, which in turn augmented the allure of the Exchange, and because it created higher profits for the NYSE, which collected fees from brokers based on total commissions.

Under Section 11(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78k(a)(1), and Securities Exchange Commission ("SEC" or "Commission") Rule 11a-1, 17 C.F.R. § 240.11a-1, however, it is illegal for floor brokers to trade on the NYSE for their own accounts or for accounts in which they have an interest. Accordingly, because the stock-flipping floor brokers shared in the profits, the practice violated Section 11(a) and Rule 11a-1.

The Exchange Act delegates substantial authority to the securities exchanges to regulate their own conduct and that of their members. *See* 15 U.S.C. § § 78o-3(b), -3(h), 78s(g). MFS contended that the NYSE was able to permit stock flipping by interpreting Rule 11a-1 in an obviously incorrect manner, namely by excluding profit sharing arrangements from the definition of "interest in an account." MFS also maintained that the NYSE's support for flipping was surreptitious; thus the Exchange took various steps, such as declining to issue official statements on its policy with respect to stock flipping, in order to avoid attention and ultimate responsibility for the persistence of the practice.

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In late 1997, the SEC and the United States Attorney's Office for the Southern District of New York began an investigation of stock flipping.[1] MFS claimed that when senior NYSE officials met with the investigators, the Exchange officials attempted to cover up NYSE practices and curry favor with the investigators by scapegoating MFS. This was done by providing false information about MFS and by concealing relevant information, for instance, as to the extent of stock flipping that was occurring on the Exchange.

On February 25, 1998, the Savarese brothers were arrested on a charge that they had violated Section 11(a) by flipping stocks. Shortly thereafter, the SEC began an action against the Savarese brothers and against MFS. On the same day as the arrests, the NYSE expelled MFS from Exchange membership and cut MFS's phone lines on the Exchange floor. According to MFS, these actions violated both the Exchange Act and the rules of the NYSE, because each requires notice and an opportunity to be heard before a member's privileges can be revoked. MFS, in fact, did not receive a pre-termination hearing before the NYSE. In addition, according to MFS, because the NYSE did not proceed according to its disciplinary rules, MFS was barred

1. Following its investigation, the SEC filed an administrative action against the NYSE in 1999 alleging that the Exchange had failed to enforce Rule 11a-1. The district court subsequently determined that the NYSE had failed to fulfill its requirements under the Exchange Act. While sentencing various defendant floor brokers for violations of Section 11(a), Judge Rakoff also noted that the NYSE's effort to enforce the rules of the Exchange Act was "anemic" and "makes a mockery" of the language of the Act. *See United States v. Oakford Corp.*, No. 98-Cr.-144, 1999 WL 1201725, at *5 (S.D.N.Y. Dec. 13, 1999).

from seeking SEC review of the NYSE's termination of MFS's Exchange membership. MFS, therefore, was allegedly left without any recourse from, or source of review of, the Exchange's actions.[2]

On July 27, 2000, MFS brought this suit alleging both a group boycott in violation of the Sherman Act, 15 U.S.C. § 1, and a breach of contract. MFS claimed that the termination of its Exchange membership, occurring as it did without notice and without an opportunity to be heard, amounted to participation by the NYSE in a group boycott. And, because MFS's membership contract required the NYSE fairly and accurately to advise MFS of the rules of the Exchange, MFS argued that the NYSE's failure so to inform MFS, with respect to the rule that outlaws stock flipping, meant that the Exchange had breached its contract with MFS.

In due course, the NYSE moved to dismiss the claims under Fed. R. Civ. P. 12(b)(6). It suggested multiple reasons for dismissing the Sherman Act claim including: (1) the Exchange's absolute immunity from antitrust suits for actions taken by it in connection with its regulatory duties under the Exchange Act; (2) the implied repeal (by the Exchange Act) of the antitrust laws, with respect to regulatory decisions of the Exchange (including membership termination); (3) the

2. MFS also contended that this is the only time that a membership revocation had ever occurred in this manner and that all the other brokers and firms engaging in stock flipping had been given the protection of the NYSE's disciplinary rules and procedures. MFS argued, moreover, that the NYSE's termination of MFS without the usual notice and opportunity to be heard was part of the Exchange's effort to cover up its own awareness and support of the illegal activity.

applicability, in this case, of a rule of reason analysis rather than a per se Sherman Act analysis, and, hence, of the rule of reason requirement — not here met — that the complaint allege an anticompetitive effect on the marketplace; and (4) the failure, since MFS had not pleaded that the Exchange's actions involved more than one party, adequately to allege a conspiracy. With respect to the claim for breach of contract, the NYSE claimed absolute immunity.

The district court granted defendant's motion and dismissed the case in an order dated January 22, 2001. *MFS Secs. et ano. v. New York Stock Exch., Inc.*, No. 00-Civ.-5600, 2001 WL 55736 (S.D.N.Y. Jan. 23, 2001). The court held that the contract claim must be dismissed for the reasons it had stated in *D'Alessio v. New York Stock Exch., Inc.*, 125 F. Supp. 2d 656 (S.D.N.Y. 2000), a companion case with similar facts, which had held that the Exchange and its officers are entitled to absolute immunity from such a suit because of the quasi-governmental nature of the interpretive and referral functions of the Exchange. *MFS. Secs.*, 2001 WL 55736, at *1. With respect to the Sherman Act claim, the court held that because the NYSE, as a self-regulating securities exchange, was under a statutorily imposed obligation to oversee both Exchange membership and the enforcement of Exchange rules, a rule of reason analysis under the antitrust laws was the appropriate way of reviewing the claim of group boycott. Applying the rule of reason, the court determined that MFS's claim must be dismissed since its complaint had failed to state the minimum facts required to find an unreasonable restraint on competition — namely, MFS had not alleged the existence of any anticompetitive effects. *Id.*

Appendix A

DISCUSSION

On appeal, MFS claims (1) that the district court's application of the antitrust rule of reason was inconsistent with Supreme Court precedent; (2) that, in any event, the allegations in the complaint satisfied the rule of reason analysis; and (3) that the district court erred in holding that defendant had absolute immunity for breach of contract. MFS also contends that none of the alternate rationales for dismissal that the NYSE argued below, and again on appeal, apply.[3]

A. Standard of Review

The district court's dismissal pursuant to Fed. R. Civ. P. 12(b)(6) is subject to *de novo* review, with the appellate court accepting as true all well-pleaded factual allegations. *Lee v. Bankers Trust Co.*, 166 F.3d 540, 543 (2d Cir. 1999). The reviewing court may, of course, affirm on any ground appearing in the record below. *Shumway v. United Parcel Serv., Inc.*, 118 F.3d 60, 63 (2d Cir. 1997).

B. The Contract Claim

In dismissing MFS's contract claim, the district court relied on *D'Alessio v. New York Stock Exch., Inc.*, 125 F. Supp. 2d 656 (S.D.N.Y. 2000). Since the district court's decision in the instant case, we have affirmed the lower court in *D'Alessio*. *See D'Alessio v. New York Stock Exch., Inc.*, 258 F.3d 93 (2d Cir. 2001), *cert. denied*, No. 01-590, 2001 WL 1241157 (Dec. 10, 2001).

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3. The NYSE makes several additional arguments before us: that plaintiff Marco Savarese does not have standing to sue and that appellants failed to identify the alleged contractual provision that was breached.

D'Alessio's claim arose out of a set of events similar to those in this case. D'Alessio had participated in stock flipping and had sued the NYSE alleging that it had failed accurately to interpret Section 11(a) and, in turn, had failed to monitor D'Alessio's compliance with the Act. We agreed with the district court's dismissal of the suit and held that the "NYSE is immune from liability for claims arising out of the discharge of its duties under the Exchange Act." *Id.* at 104. Specifically, we found that the "NYSE's alleged misconduct falls within the scope of quasi-governmental powers delegated to the NYSE pursuant to the Exchange Act and, therefore, . . . absolute immunity precludes D'Alessio from recovering money damages in connection with his claims." *Id.* at 106.

As both sides recognize, our decision in *D'Alessio* controls MFS's contract claim. Accordingly, we affirm the district court's dismissal of that claim.

C. The Sherman Act Claim

Though MFS seeks treble damages for antitrust violations and alleges that a group boycott occurred, MFS's complaint and its arguments on appeal make clear that the putative lack of process offered by the NYSE and the asserted absence of any SEC review of the termination of MFS's membership are key to MFS's Sherman Act allegations.[4]

4. That the procedural deficiencies in MFS's termination are relevant to its suit under the Sherman Act is supported by the requirements that the Exchange Act imposes on self-regulating organizations ("SROs"), such as the NYSE. Specifically, under the Exchange Act, one of the duties of SROs is to regulate their own membership. 15 U.S.C. § 78f. Because membership regulation

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Appendix A

The district court, in dismissing MFS's case pursuant to a rule of reason analysis, did not explicitly address the questions surrounding the alleged absence of process. Though we agree that the claim cannot currently continue in the district court, we do so (1) because we cannot say that administrative review capable of addressing MFS's complaints is unavailable, and (2) because the existence and outcome of such review could be crucial to the issues before us, and must, therefore, precede any court consideration of these issues.

1. The Existence of Administrative Review

Section 6(b)(7) of the Exchange Act requires national exchanges, such as the NYSE, to "provide a fair procedure for . . . the prohibition or limitation by the exchange of any person with respect to access to services offered by the exchange or a member thereof." 15 U.S.C. § 78f(b)(7). Section 6(d)(1) of the Act requires notice and a hearing for any such disciplinary action. 15 U.S.C. § 78f(d)(1). Though the Act provides for summary proceedings in certain circumstances — in which case notice and a hearing will not occur — it does also require that "[a]ny person aggrieved by any such summary action shall be promptly afforded an opportunity for a hearing by the exchange in accordance with

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necessarily involves, at least from time to time, termination of members, it seems unlikely that termination alone can trigger a Sherman Act violation. *See id.* § 78f(c)-(d). In other words, because membership regulation is a duty, such regulation cannot always or necessarily lead to liability under the antitrust laws. Not surprisingly, some of the NYSE's defenses to the Sherman Act claims, including implied repeal and immunity, rely heavily on this notion.

[§ 78f(d)(1)-(2)]." 15 U.S.C. § 78f(d)(3). Moreover, the NYSE's rules, enacted in accordance with this section of the Exchange Act, impose similar requirements. *See* NYSE Rule 475. And, the Exchange Act mandates that the national exchanges comply with their own rules. 15 U.S.C. § 78s(g).

Furthermore, Section 19 of the Exchange Act provides for SEC review of disciplinary actions taken by the NYSE. 15 U.S.C. § 78s(d)-(e).[5] Through this review, the SEC can affirm the sanctions imposed by the Exchange or lift them, impose various other sanctions, and/or remand for any further proceedings as necessary. *See* 15 U.S.C. § 78s(e)-(f). Of special significance to the instant case is the fact that, in conducting this review, the SEC must consider the effects on competition that the disciplinary action of the Exchange might have had. And, these effects are meant to affect the SEC's determination of whether the sanctions imposed were appropriate. *See* 15 U.S.C. § 78s(f). Finally, a party aggrieved by the decision of the SEC can seek review of that ruling in a court of appeals. 15 U.S.C. § 78y(a)(1).

MFS claimed that the route of review outlined above was not available because the NYSE had not proceeded in accordance with its disciplinary rules and that, as a result, there were no adverse disciplinary proceedings for the SEC to consider. This argument relies on the fact that Section 19 of the Exchange Act uses the term "final disciplinary sanction." *See* 15 U.S.C. § 78s(d). Though Section 19 does

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5. The Act refers to the "appropriate regulatory agency" as undertaking the review of the SRO. 15 U.S.C. § 78s(d)(1). In the circumstances before us, the SEC is that agency and the NYSE is the SRO.

provide for review of a "final disciplinary sanction" of the NYSE, the scope of available review is by no means as limited as MFS would have us believe. The plain language of the statute states that the NYSE must notify the SEC, or the aggrieved party may notify the SEC and receive review:

> [i]f any self-regulatory organization imposes any final disciplinary sanction on any member thereof or participant therein, denies membership or participation to any applicant, *or prohibits or limits any person in respect to access to services offered by such organization* or member thereof or if any self-regulatory organization (other than a registered clearing agency) imposes any final disciplinary sanction on any person associated with a member or bars any person from becoming associated with a member. . . .

15 U.S.C. § 78s(d)(1) (emphasis added). As a result, review would seem to be available in this case because, as MFS states in its claim for relief, the NYSE limited MFS's access to services. Compl. ¶ 91, 113.

In addition to the text of the statute, both past SEC rulings and the case law in this circuit indicate that formal disciplinary proceedings by the NYSE are not a prerequisite for SEC review of actions taken by the Exchange. Thus, the SEC exercised jurisdiction in *Notice of Application of William Higgins*, 51 Fed. Reg. 6186-04, 1986 WL 89969 (F.R.) (Feb. 20, 1986), which arose out of the NYSE's denial of a member's request to install an unrestricted phone line on the floor of the Exchange. The member appealed that

decision to the SEC. And, the fact that the member's appeal was not from a disciplinary action, but rather from a regulatory decision, did not prevent the SEC from reviewing the Exchange's actions. As the SEC explained, "[u]nder section 19(d)(2) of the Act, the Commission's review authority extends to prohibitions of, and limitations on, any person's access to services offered by an SRO or member thereof." *Id.* at *6188.

This court, moreover, has agreed with the SEC that the Commission has jurisdiction over NYSE regulatory actions. In affirming the dismissal of an antitrust case that the same person (Higgins) brought against the NYSE with regard to the same conduct, we stated that "Section 19(d) of the Exchange Act . . . provides for SEC review of disciplinary and regulatory actions by self regulating organizations such as the [NYSE]." *Higgins v. New York Stock Exch., Inc.*, 942 F.2d 829, 833 (2d Cir. 1991). *See also In re Application of Leon Greenblatt III*, Exchange Act Release No. 34-34953, 1994 WL 640090, at *1 (Nov. 9, 1994) ("We believe that the action taken by the [Chicago Stock Exchange, denying plaintiff access to the trading floor without notice or an opportunity to be heard] constitutes a denial of Greenblatt's access to services offered by the Exchange. Consequently, it is subject to Commission review.").[6]

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6. MFS makes additional arguments with respect to why the SEC cannot review the NYSE's action. Beyond the fact that the action was not a normal disciplinary action, appellants claim that there was no formal notice as required under Section 19(d)(1). As the NYSE points out, however, filing of notice is not a condition precedent to SEC review. Indeed, the SEC's decision in *Higgins* squarely rejected

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The NYSE's revocation of MFS's membership and its actions to cut off phone service manifestly limited MFS's access to services. Accordingly, SEC review was available to MFS. Given that availability, MFS cannot, by denying its existence, and hence failing to seek it, create the very procedural deficiency (in its membership termination) as to which it now complains. That is not to say, of course, that MFS's termination by the Exchange complied with the procedural requirements of the Exchange Act or of the NYSE rules. Indeed, whether the membership revocation contravened the Act and the rules is precisely the question that the SEC, in reviewing MFS's termination, could consider. Moreover, under the Exchange Act, the decision of the SEC as to the propriety of that termination is itself directly reviewable in a court of appeals. 15 U.S.C. § 78y(a)(1).

2. The Significance of Administrative Review

As the Supreme Court has noted, the types of issues presented in this case are not uncommon. *Ricci v. Chicago Mercantile Exch.*, 409 U.S. 289, 299 (1973). Such questions:

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the same procedural arguments: "Under section 19(d)(2), however, filing by the SRO is not the exclusive method of commencing a Commission review procedure. Rather, section 19(d)(2) provides that '[a]ny action with respect to which an SRO is required by [Section 19(d)(1)] to file notice shall be subject to review by [the Commission] on its own motion. . . .' The Commission may commence such a review irrespective of whether a filing is, in fact, submitted by the SRO." *Higgins*, 51 F.R. 6186, at *6188 (alterations in original).

> arise[ ] when conduct seemingly within the reach of the antitrust laws is also at least arguably protected or prohibited by another regulatory statute enacted by Congress. Often, but not always, the other regime includes an administrative agency with authority to enforce the major provisions of the statute in accordance with that statute's distinctive standards, which may or may not include concern for competitive considerations.

Id. at 299-300. In *Ricci*, the Court considered a claim brought by Ricci, a member of a commodities exchange, that the exchange's transfer of his membership violated the antitrust laws. Ricci's claim involved "issues of fact and questions about the scope, meaning, and significance of Exchange membership rules." *Id.* at 305. These matters, the Court explained:

> are matters that should be dealt with in the first instance by those especially familiar with the customs and practices of the industry and of the unique market-place involved in this case. . . . They are matters typically lying at the heart of an administrative agency's task and here they appear to be matters that Congress has placed within the jurisdiction of the Commodity Exchange Commission. We should recognize 'that the courts, while retaining the final authority to expound the statute, should avail themselves of the aid implicit in the agency's superiority in gathering the relevant facts and in marshaling them into a meaningful pattern.'

Id. at 305-06 (internal citations omitted) (quoting *Federal Maritime Bd. v. Isbrandsten Co.*, 356 U.S. 481, 498 (1958)). The Court, therefore, agreed with the Seventh Circuit that the district court should stay the action until the Commodity Exchange Commission could consider the claims. *Id.* at 304.

As in *Ricci*, we understand the SEC to have jurisdiction to consider many of the questions embedded in MFS's complaint and believe that administrative review will be of "material aid" to the district court in resolving the claim brought by MFS. *Id.* at 302. The propriety, under the NYSE rules and the Exchange Act, of MFS's termination is crucial both to understanding and to identifying, with any degree of specificity, MFS's antitrust claim. SEC review of MFS's termination might, for example, result in MFS's reinstatement as a member of the Exchange, thereby possibly mooting the entire antitrust claim. Conversely, the SEC might approve of MFS's termination. But in so doing, the Commission would necessarily pass on the process accorded MFS, thereby determining whether, in its judgment, the manner in which MFS was terminated violated the Exchange Act and the rules of the NYSE.[7]

Such findings by the SEC — and other analogous ones — would shape the claim alleged in this suit and clarify the issues before the district court.[8] Depending on how the SEC rules on these issues, the district court could be deciding

7. Additionally, the SEC might remedy some of the wrongs inflicted and hence reduce the damages allegedly suffered by MFS.

8. As noted above, the SEC's determinations would be subject to review by a court of appeals. Following the appellate court's decision, MFS might then be able to continue the instant suit in the district court.

whether a procedural deficiency under the Exchange Act in a NYSE membership termination can render that termination a group boycott under the Sherman Act. Or, if the SEC rules that the process was sufficient to meet the requirements of the Exchange Act, the court could face the question of whether a method of termination that complies with the Exchange Act can, nonetheless, give rise to a Sherman Act violation.[9] The same SEC determinations would make it considerably easier for the court to decide (1) whether the NYSE enjoys immunity from antitrust liability; (2) whether the Exchange Act worked an implied repeal of the antitrust laws in these circumstances; or (3) whether, if a possible antitrust contravention exists, the proper Sherman Act examination is that provided by a per se or rule of reason analysis — all questions that have been raised in this case.

By referring certain issues to administrative review by the SEC prior to permitting federal court adjudication of this dispute, we are utilizing what is usually called the doctrine of primary jurisdiction. *See Higgins*, 942 F.2d at 833-34 (discussing and describing the doctrine). Though the Supreme Court did not mention primary jurisdiction by name in the *Ricci* decision, the Seventh Circuit opinion, which the Court affirmed, explicitly invoked that doctrine in holding that the Commodity Exchange Commission must consider various claims before the suit could properly continue before the district court. *Ricci v. Chicago Mercantile Exch.*, 447 F.2d 713, 718-19 (7th Cir. 1971).

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9. Thus, as in *Ricci*, Commission determination could put "the antitrust court . . . in a position to make a more intelligent and sensitive judgment as to whether the antitrust laws will punish what an apparently valid rule of the Exchange permits." *Id.* at 307-08.

The Supreme Court had previously described primary jurisdiction as a "device to prepare the way, if the litigation should take its ultimate course, for a more informed and precise determination by the Court." *Isbrandsten*, 356 U.S. at 498-99. *Cf. Ricci*, 409 U.S. at 306 (quoting this language from *Isbrandsten* in describing its decision to afford "the opportunity for administrative action"). And, as the Supreme Court also noted in *Isbrandsten*, the use of this device avoids involving the federal courts "in comparatively abstract exposition." *Id.* at 499. The doctrine's label, however, is singularly infelicitous. The concept does not mean that the district court lacks *jurisdiction* over the dispute or that the litigant must bring the relevant claims to the administrative authority *first* (i.e., prior to filing suit in district court).

Indeed, the Seventh Circuit's holding in *Ricci*, as affirmed by the Supreme Court, demonstrates that primary jurisdiction is neither jurisdictional nor primary. While the court of appeals invoked primary jurisdiction to stop the suit from immediately proceeding further in the district court, by instructing the district court to stay the action pending agency review, it implicitly recognized both that the district court had *jurisdiction* and that bringing the suit *originally* in that court was perfectly proper. *Ricci*, 447 F.2d at 720.[10]

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10. We indicated the same view of primary jurisdiction when we said in *Higgins*, that plaintiff's "decision to petition the SEC was not a jurisdictional prerequisite to filing his antitrust claim" 942 F.2d at 830. In this respect, we would further note that the district court's jurisdiction and consequent ability to stay the action pending administrative review removes the risk that the statute of limitations will expire before the administrative review is complete. *See id.* at 831-34.

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The Holy Roman Empire was, in the words of Voltaire, "neither holy, nor Roman, nor an empire." François Marie Arouet de Voltaire, *Essai sur les Moeurs et l'Esprit des Nations* 70 (1769). It was effective nonetheless. Similarly, "primary jurisdiction" can be used to denominate what should be done in cases of this sort. And, so long as the words are not treated as implying what they do not intend, little harm will flow from this terminology.

* * *

The decision of the district court to dismiss MFS's action is reversed. We remand the case to the district court with directions to stay the proceedings until such time as the SEC may have acted upon a promptly filed application for review. It will be up to the SEC, in the first instance, to consider whether such an application is timely. *See* 15 U.S.C. § 8s(d)(2).

Affirmed in part, and vacated and remanded in part, with directions.

APPENDIX B — MEMORANDUM ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK DATED JANUARY 22, 2001 AND DOCKETED JANUARY 23, 2001

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

No. 00 Civ. 5600 (JSR)

MFS SECURITIES et ano.,

Plaintiffs,

–v–

NEW YORK STOCK EXCHANGE, INC.,

Defendant.

MEMORANDUM ORDER

JED S. RAKOFF, U.S.D.J.

Plaintiffs allege that defendant New York Stock Exchange (the "Exchange") terminated the Exchange membership of plaintiff MFS Securities ("MFS") without notice or an opportunity to be heard as part of a conspiracy to conceal various wrongdoing by the Exchange and its officers and that in so doing the Exchange participated in a group boycott in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1. Plaintiffs also allege breach of contract. Defendants move to dismiss pursuant to Fed. R. Civ. P. 12(b)(6). For the reasons that follow, the motion must be granted.

Appendix B

While in many circumstances allegations of a group boycott state a "per se" violation of the antitrust laws, *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284, 293 (1985), the statutorily imposed "anticompetitive" obligations of a self-regulating securities exchange under the Securities Exchange Act to define and limit membership and enforce Exchange rules against members mandate application of the "rule of reason," rather than a per se analysis, when a group boycott is alleged against such a securities exchange. *Silver v. New York Stock Exchange*, 373 U.S. 341, 360 (1963); *Jacobi v. Bache & Co., Inc.*, 520 F.2d 1231, 1238 (2d Cir. 1975) (Friendly, J.). A well-pleaded complaint must in these circumstances state at least bare minimum facts constituting an unreasonable restraint on competition. *State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997). Plaintiffs have, however, failed to allege any anticompetitive effect whatsoever. Plaintiffs' antitrust claim must therefore be dismissed for failure to state a claim upon which relief can be granted. *See Associated General Contractors v. California State Council of Carpenters*, 459 U.S. 519, 528 n.17 (1983).

Plaintiffs' second claim, for breach of contract, must also be dismissed for the reasons stated in this Court's decision in *D'Alessio v. New York Stock Exchange*, No. 00 Civ. 269, 2000 WL 1458801 (S.D.N.Y. Sept. 29, 2000).

Accordingly, plaintiffs' complaint is hereby dismissed, with prejudice, in its entirety. Clerk to enter judgment.

SO ORDERED.

s/ Jed S. Rakoff
JED S. RAKOFF, U.S.D.J.

Dated: New York, New York
January 22, 2001

APPENDIX C — EXCERPTS OF TRANSCRIPT OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK DATED NOVEMBER 28, 2000

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

DOCKET NO.: CV-00-5600 (JSR)
New York, New York
November 28, 2000

MFS SECURITIES CORP, et al.,

Plaintiffs

-vs-

NEW YORK STOCK EXCHANGE INC,

Defendant

TRANSCRIPT OF CIVIL CAUSE FOR CONFERENCE

BEFORE THE HONORABLE JED S. RAKOFF
UNITED STATES DISTRICT JUDGE

* * *

[23] * * *

[23] THE COURT: But wait a minute. They did provide this [24] other review, after the fact — I understand the distinction in terms of what you say your injury was.

However, of course, the ultimate injury is economic and could be remedied in damages, so even an after-the-fact review would not necessarily have been without value to you.

I agree with you it's not before me, but it would still be helpful for me to know what dates you put on the facts that are alleged in paragraph one oh seven.

MR. AMOROSA: Unfortunately, I don't have those in my mind. My recollection is it was some weeks after MFS was terminated, and the subject matter of it, again — again, please don't hold me to this specifically; I've read this, but some time in the past — related to the failure to accord MFS with the due process rights it was entitled to in the statutes and in the New York Stock Exchange rules. And that was a proceeding — and I say that very loosely — which occurred before a committee of the board of directors of the New York Stock Exchange.

* * * *

APPENDIX D — COMPLAINT DATED JULY 27, 2000

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

COMPLAINT

Docket No.

JURY TRIAL DEMANDED

MFS SECURITIES CORP. and MARCO SAVARESE,

Plaintiffs,

- against -

NEW YORK STOCK EXCHANGE, INC.,

Defendant.

COMPLAINT

The plaintiffs, MFS Securities Corp. and Marco Savarese, allege the following against the defendant, New York Stock Exchange, Inc., upon information and belief and through their attorney, Dominic F. Amorosa:

PRELIMINARY STATEMENT

1. Plaintiffs bring this action to redress wrongs perpetrated against them by defendant in violation of the antitrust laws of the United States. Plaintiff, MFS Securities Corp. ("MFS"),

owned entirely by the plaintiff, Marco Savarese, was for years a member corporation and organization in good standing of the defendant, New York Stock Exchange, Inc. ("NYSE"), a not-for-profit association of securities dealers, where MFS earned money primarily by executing orders to trade securities for others, including other members and member organizations of the NYSE. On February 25, 1998, the defendant, without notice and without providing the plaintiffs with an opportunity to be heard at a hearing, in violation of NYSE Rules, and in violation of federal securities law, arbitrarily and illegally terminated MFS' status as a member organization of the NYSE, arbitrarily and illegally terminated MFS' privileges to transact business at the NYSE and arbitrarily and illegally imposed a group boycott against MFS by NYSE members, which, in turn, destroyed MFS' business. The defendant's actions were undertaken in bad faith in an effort to curry favor with the United States Attorney's Office for the Southern District of New York ("USAO") and the Securities & Exchange Commission ("SEC") which were then investigating certain illegal practices which defendant and certain of its representatives engaged in for years, and which defendant was on February 25, 1998 concealing. The defendant deliberately chose to and did destroy MFS' business at the NYSE by means of a group boycott as a part of its effort to conceal its own involvement in serious crimes.

THE PARTIES AND RELEVANT OTHERS

2. The plaintiff, MFS, is a corporation which was a member corporation and organization of the NYSE since 1980. It has been a broker dealer in securities registered with the SEC since 1980.

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3. The plaintiff, Marco Savarese, a New York resident, owned 100% stock ownership in MFS since its inception, and has been himself a member of the NYSE, and an allied member of the NYSE. Marco Savarese spent a large part of his entire life building the business of MFS as a member organization of the NYSE by acquiring customers which utilized the services of MFS on the floor of the NYSE to execute their orders to buy and sell securities.

4. John Savarese, the son of the plaintiff, Marco Savarese, was a member of the NYSE from at least 1993 to September 1999. He was employed by MFS as a floor broker until February 25, 1998.

5. Mark Savarese, the son of the plaintiff, Marco Savarese, was a member of the NYSE from at least 1993 to September 1999. He was employed by MFS as a floor broker until February 25, 1998.

6. At all times relevant herein, the defendant, NYSE, was a Not-for-Profit New York corporation with its principle place of business at 11 Wall Street, New York, New York.

7. Richard A. Grasso, named herein as a co-conspirator but not as a defendant, has been from January 1, 1995 to the present the Chairman of the Board of Directors and Chief Executive Officer of the defendant, NYSE. From 1988 to January 1, 1995 Grasso was the President and Chief Operating Officer of the NYSE. From January 1, 1991 to January 1, 1995, he was also Executive Vice Chairman of the Board of Directors of the NYSE. The Board of Directors of the NYSE governs the NYSE and regulates the business conduct of its members and is elected by the members of the NYSE.

8. Edward A. Kwalwasser, named herein as a co-conspirator but not as a defendant, is a lawyer and the current Group Executive Vice President at the NYSE, responsible for Market Surveillance, Enforcement and Member Firm Regulation. Kwalwasser at all times relevant to this Complaint, reported to Grasso.

9. Robert J. McSweeney, named herein as a co-conspirator but not as a defendant, was, from June 1989 to the present, Senior Vice President of Market Surveillance at the NYSE and reported to Kwalwasser and to Grasso. McSweeney was responsible for the Division at the NYSE which monitored trading for violations of securities laws and NYSE rules.

10. Brian M. McNamara, named herein as a co-conspirator but not as a defendant, was from 1988 to 1997 the Managing Director of the regulatory development and specialist performance evaluation department of the NYSE during which he was responsible for certain rule development and interpretation at the NYSE. In May 1997 McNamara became vice president of the member trading department at the NYSE. During all times relevant McNamara reported to McSweeney and Kwalwasser and Grasso.

JURISDICTION

11. This Complaint is brought pursuant to Title 15 U.S.C. Sections 1-15 (Sherman and Clayton Anti-Trust Acts), and Title 28 U.S.C. Section 1331 and the Court's ancillary jurisdiction. Venue lies in this District pursuant to Title 28 U.S.C. Section 1391(a).

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THE NYSE AND ITS MEMBERS

12. At all times relevant herein, the defendant, NYSE, was a National Securities Exchange within the meaning of the Securities Exchange Act of 1934 ("The Exchange Act") and the rules and regulations thereunder, and was regulated by the SEC. The Exchange Act empowers the NYSE itself with regulatory duties and responsibility with respect to some of its activities. It is in this respect a self-regulatory organization, and therefore subject to the due process clause of the fifth amendment of the United States Constitution. The NYSE is an association of securities dealers which exclusively through its members and member firms provided a market place, in the form of an auction, for the trading of certain listed securities. This auction market is located at 11 Wall Street, New York, New York, and is known as the "floor". NYSE member brokers known as specialists manage and operate the auction markets on the floor for individual securities at what are called "posts". For example, a specialist would manage trading in the stock of IBM, one of the approximately 3100 listed NYSE securities, at the IBM "post". The specialist would be responsible, among other things, for determining the bid and offer prices for the stock based upon the supply and demand for this stock. The business of the NYSE and each of its members affects interstate and foreign commerce.

13. At all times relevant to this Complaint, an individual or entity could become a member of the NYSE by purchasing a seat on the NYSE or by leasing a seat from a member of the NYSE, subject to the approval of the NYSE and after agreeing to abide by the rules of the NYSE. Only members

and member organizations and people affiliated with them are allowed to use the trading facilities of the NYSE. If a non-member individual or entity wishes to trade a NYSE listed security on the NYSE he or she must place his or her order, directly or indirectly, with a member or member organization of the NYSE. Among the members of the NYSE are independent floor brokers, who are also known as $2.00 brokers. Traditionally, these $2.00 brokers stood ready for a commission to execute orders on behalf of customers on the floor of the NYSE for the purchase and sale of securities. Their customers would include other members of the NYSE, who, in turn, would represent private persons or entities. For instance, a brokerage firm, which is also a member organization of the NYSE, could place an order with a $2.00 broker to execute a trade on behalf of one of its (the brokerage firm's) customers. Independent floor brokers are known as $2.00 brokers because at one time, long since past, they charged their customers as a commission an average of $2.00 for each one hundred shares of securities they traded on the floor. This charge was assessed whether or not the customers made profits or losses on the trades. Generally, $2.00 brokers are required to be agents for their customers, and owe a fiduciary duty to them to obtain the best prices for their orders.

14. There are approximately 1366 regular members of the NYSE. Of this amount, approximately 500 are $2.00 brokers. Two of the $2.00 broker members of the NYSE were John Savarese and Mark Savarese, sons of plaintiff, Marco Savarese. The plaintiff, Marco Savarese, operated his $2.00 brokerage business through the plaintiff, MFS, a registered broker dealer of securities, and an operational member corporation and organization of the NYSE until February 25, 1998 when the

defendant arbitrarily and illegally terminated its status as a member organization and imposed a group boycott against MFS by defendant's members and member organizations.

15. From 1980 to February 1998 MFS' $2.00 brokerage business was very successful. MFS had developed many customers for whom it executed trades on the floor for commissions, which affected interstate commerce. By 1997 MFS was earning approximately $3 million a year in commissions. The business of MFS was dependent upon other members and member organizations of the NYSE, as well as its use of the facilities of the NYSE.

CONTRACT BETWEEN MFS AND NYSE

16. When plaintiff, MFS, became a member organization of the NYSE, it entered into a contract with the NYSE pursuant to which it paid a fee to the NYSE for such membership and promised to pay dues and transaction fees to maintain its membership and also promised to abide by the NYSE Constitution and NYSE rules. In turn, the NYSE promised MFS that it would advise it fairly and accurately of the rules and laws under which it must operate, and to fairly apply those rules and laws to MFS.

DUTY OF NYSE TO PLAINTIFFS

17. Apart from the contract, the NYSE had a duty to its members and member organizations, in accordance with Section 19(g) of the Exchange Act, to abide by and enforce its own rules.

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LAWS AND RULES GOVERNING MEMBERS OF THE NYSE

18. At all times relevant to this Complaint, subject to certain exceptions not applicable here, Section 11(a) of the Exchange Act (Title 15 U.S.C. Section 78(k)(a)(1) and Rule 11a-1 thereunder (Title 17, CFR Section 240.11(a-1), made it illegal for a $2.00 broker to become a partner in an account of any customer for whom he or it was trading on the floor, to initiate and effect trades for his or its own account on the floor, to trade for an account on the floor in which he or it held an interest, and to exercise discretion over an account on the floor.

19. In accordance with these laws and regulations, and their antecedents, the NYSE promulgated, among other rules, its own Rule 352(c) which specifically prohibited all members of the NYSE from sharing in the profits and losses of trades they executed on behalf of any of their customers. This Rule provided in relevant part as follows:

> "No member, member organization, allied member, registered representative or officer shall, directly or indirectly, (i) take or receive or agree to take or receive a share in the profits, or (ii) share or agree to share in any losses, in any customer's account or of any transaction effected therein." (Emphasis Added)

20. At all times relevant to this Complaint, NYSE Rule 90(a), with exceptions not relevant here, prohibited a member of the NYSE from effecting any transactions on the floor for his own account.

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21. At all times relevant to this Complaint, NYSE Rule 91 prohibited a member, who accepted an order from a customer to buy a security, from filling this order by selling the security on behalf of an account in which the member had a direct or indirect interest.

22. At all times relevant to this Complaint, NYSE Rule 92(a) prohibited a member from buying any security for his own account or for any account in which he was directly or indirectly interested, while such member possessed an unexecuted market order to buy the same security on behalf of one of his customers. It also prohibited a member from selling any security for any such account while he held an unexecuted market order to sell such a security for a customer.

23. At all times relevant to this Complaint, NYSE Rule 111(a), with exceptions not relevant here, prohibited a member from initiating transactions, while on the floor, for an account in which he had an interest.

24. The laws and rules outlined in paragraphs 18-23 were designed, among other reasons, to protect public customers against self-dealing by the NYSE and its members and to ensure that members acted as agents for their customers' orders and did not develop conflicts of interests between their customers' orders and their own personal trading.

THE DEFENDANT AND ITS CO-CONSPIRATORS BEGIN A CONSPIRACY TO VIOLATE THE FEDERAL SECURITIES' LAWS

25. Beginning no later than June 1991 and continuing through mid-1998, the defendant and others, including Richard

Grasso, Edward Kwalwasser, Robert McSweeney and Brian McNamara, conspired to violate, among other laws, Sections 11(a) and Rule lla-1. These conspirators wilfully and knowingly agreed among themselves and others to permit illegal trading on the floor by $2.00 brokers and to encourage other $2.00 brokers to engage in this illegal activity.

26. No later than June 1991, the conspirators became aware through very sophisticated surveillance techniques employed by the NYSE, which monitored and analyzed trading on the floor by $2.00 brokers, that $2.00 brokers of the NYSE were sharing in the profits of flip trades they executed on the floor on behalf of the accounts of certain of their customers.

27. The conspirators knew, and consciously avoided knowledge, that these profit sharing arrangements conferred an "interest" in such accounts upon the $2.00 brokers and triggered a partnership relationship between the $2.00 brokers and their customers, in violation of Section 11(a)(1) and Rule 11a-1. The conspirators also knew that these profit sharing arrangements violated NYSE Rule 352(c) and, at times, the rules outlined in paragraphs 19-22 above.

28. A flip trade, also known as "flipping" or "trading for 1/8's" or "intra-day trading" typically, but not exclusively, occurs when a $2.00 broker buys for a customer's account a particular security on the floor and shortly thereafter "flips", or executes another trade, in which he sells the same security at a profit of 1/8 point ($.125), and the $2.00 broker shares the profit on these trades with his customer. For example, if a stock is being offered for $10.00 per share and the bid on the stock is $9.875 ($9 7/8), the $2.00 broker would seek to buy the stock at the lower price and hope to sell it (or "flip" it)

immediately thereafter at the higher price. When successfully executed, flip trades generally resulted in a profit of 1/8 of a point or $.125 to be shared by the customer and the $2.00 broker. If the broker has an agreement with his customer to receive 50% of the profits generated by his trades on behalf of that customer's account and if the broker buys and sells 10,000 shares of a stock and makes a profit of 1/8 of a point on the transaction, the transaction will generate a gross profit of $1250.00, of which the broker will receive 50%, or $625.00 for this one trade, less trading expenses and transaction fees. The customer receives the other 50%.

29. The practice of flipping on the NYSE floor by a single $2.00 broker could involve the buying and selling of thousands of shares of the same stock per day as the price of a stock ticked up and down. A $2.00 broker, who had a 50% profit sharing arrangement with his customer, might buy and sell a particular stock 10 times per day in 5,000 share lots. If he successfully captured the 1/8 point spread each time, he would earn a total of $6,250 in profits for the customer's account and receive 1/2 of this himself for one day's work of flipping, less trading costs and transaction fees paid to the NYSE. There was no guarantee that a profit would be made in this trading strategy. Because, however, the $2.00 brokers were on the floor of the NYSE, they had certain advantages over people who were not on the floor. For example, they might learn from what is occurring at the post whether there is selling or buying pressure with respect to a particular security which could influence the bid and ask prices on that security within the next few seconds. This information would give them an advantage over individuals who did not have it. This was one of the reasons for the enactment of Section 11(a) and Rule 11a-1 and NYSE Rule 352(c).

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30. Sharing profits in flip trades by floor brokers was very profitable for the defendant, NYSE, as well, and this was one of the reasons that the conspirators approved of the illegal flipping arrangements on the floor. In 1991 the NYSE required a transaction fee to be paid to the NYSE by $2.00 brokers based upon the total amount of commissions received by the $2.00 brokers. The more money the $2.00 brokers received by profit sharing flipping arrangements, the more money was required to be paid by them to the NYSE.

31. This practice of sharing profits with customers by flipping, which made the broker a partner in his customer's account, and therefore gave the broker ownership of the account in violation of the laws and rules outlined in paragraphs 18-23 above, differed fundamentally from the traditional commission structure employed by $2.00 brokers with their customers. This traditional structure allowed $2.00 brokers to negotiate with their customers for a set rate of commission based upon the number of shares traded on behalf of the customer by the $2.00 broker, or based upon a flat fee. This practice resulted in the $2.00 broker being paid a set rate whether or not the trades resulted in a profit for the customer. This was the ordinary and proper agency relationship between the $2.00 broker and the customer. Since the $2.00 broker would get paid his volume-based commission whether or not the trade was profitable, he had no financial incentive to favor any particular customer over any other customer while on the floor. There have been innumerable occasions when such favoring created losses for members of the public; these losses would occur, for example, when the $2.00 broker would not obtain the best price for members of the public because he was obtaining the best price for his own account. Moreover, if the $2.00

broker was working for a fixed commission, he did not have a financial motive to trade on the floor without receiving an order from his customers, which motive existed when he was trading for an account in which he was sharing profits. Such discretionary trading practices occurred frequently on the floor with the approval of the NYSE, which "interpreted" the rules against discretionary trading in such a way as to permit floor brokers to circumvent them at will. If a $2.00 broker had a substantial financial interest in an account through a profit sharing arrangement, he had an incentive to make trading decisions on his own without consultation with his customers. At times the difference between making a substantial profit on a trade, or making a loss, comes down to a decision that must be made in a few seconds. If a broker has to speak with a customer to get the customer's permission to execute a trade, the delay in speaking with the customer to obtain that permission could result in the loss of profit on the trade. This is why the NYSE illegally permitted its floor brokers to have an advanced agreement with their customers, who were also their partners, which gave the floor brokers permission in advance to do anything they wanted to do, as long as they informed the customer in advance. This kind of permission was given by the NYSE despite the fact that it was also advising floor brokers that they could share profits with their customers in those customer accounts, which made them partners in those accounts. The NYSE thus permitted its floor brokers to both trade for accounts in which they were partners and to exercise discretion over the trading decisions in these accounts.

32. In 1991, the NYSE and the conspirators, in order to cover-up violations of the laws and rules outlined in paragraph 18-23 above and to permit $2.00 brokers to

continue to flip for a share of the profits, concocted a phony interpretation of the term "interest in an account". Again, it is illegal for a $2.00 broker to trade on the floor for an account in which he holds an interest. After a "review" of the practice of flipping for a share of the profits at the NYSE, which occurred at meetings dated June 26, 1991, August 1, 1991 and August 29, 1991 held by the Market Performance Committee of the NYSE, and attended by the conspirators, McNamara, Kwalwasser and McSweeney, and others, the conspirators informed members of the NYSE — verbally and not in writing — that the issue of whether a $2.00 broker had an "interest in an account" was one of his or her "intent" and that such an "intent" would not be presumed if the only thing that a $2.00 broker did was to share profits in an account. The conspirators were aware that this interpretation of the term "interest in an account" was false, and were very well aware that if a broker was receiving 50% of the profits from trades he was executing on the floor, he or she held an "interest" in such an account, in violation of law.

33. The conspirators also concocted a phony definition of the term "customer" within the meaning of NYSE Rule 352(c), a rule which the conspirators were required to enforce, which expressly prohibits all members of the NYSE from sharing in their customers' profits. Two dollar brokers are of course members of the NYSE, according to the definition of "member" contained in the NYSE Rules and Constitution, and are covered by Rule 352(c). The conspirators, in order to be able to continue their conspiracy, brazenly and falsely "interpreted" the term "customer" in Rule 352(a) to exclude certain customers of $2.00 brokers. Nothing was ever placed in writing with respect to this interpretation.

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34. In 1991 the conspirators falsely informed NYSE members directly and indirectly that $2.00 brokers sharing in the profits of flip trades they executed for their customers, without more, was not a violation of law or rules. The conspirator, Kwalwasser, also informed members that the laws against discretionary trading could be circumvented by simply obtaining permission from a customer in advance, permitting the members to make any trade they wanted on the floor at any time and in any amount, as long as it was reported to the customer's clerk.

35. As a result of the conspirators' publicized position that it was proper and lawful to flip and share profits, $2.00 brokers, including many who had never engaged in flipping before, began to do so. They did so upon the direct and indirect representations of the conspirators, who were charged with the duty to advise members of the impact of the securities laws and rules on their trading practices on the floor of the NYSE and to interpret for them the rules of the NYSE. Flipping for a share of the profit thereafter occurred openly and notoriously on the floor.

36. As a result of the NYSE's further "position" that the laws against discretionary trading could be circumvented at will, members who were sharing profits with their customers entered into agreements with their customers permitting the members to make all trading decisions as long as they reported such decisions to the customers' clerks.

37. Because the conspirators' "interpretation" of the law and rules was directly inconsistent with the language and purpose of the law, their interpretation was periodically

challenged by certain NYSE members who rightly worried that the conspirators were causing the securities laws to be violated, which would damage the NYSE.

38. On January 15, 1992, co-conspirator McSweeney, attended a meeting of the Market Performance Committee of the NYSE comprised of officials and members of the NYSE, which was held at 11 Wall Street, New York, New York. The discussion at this meeting once again related to the legality of flipping for a share of the profits by brokers on the floor. According to the SEC testimony of McSweeney given on January 13, 1999 during an investigation of the NYSE by the SEC:

> "[T]he discussion [at this meeting on January 15, 1992] entailed a review of the reasons why brokers representing orders for purposes of trading for eights [which is another term for "flipping"] would be compensated at a high rate that would be the *mathematical equivalent* of approximately half the profits in a transaction and the *belief* that that compensation is *appropriate*. Because of that conclusion, there was agreement that this did not present a situation that would have implication regarding the ownership of the account . . ." (Emphasis Added)

The "belief" that McSweeney referred to in the quoted testimony was the "belief" of the conspirators that flipping for a share of the profits was "appropriate". McSweeney's reference in this testimony to "mathematical equivalent" relates to the form in which the $2.00 brokers were billing their customers

for the transactions to which McSweeney was referring. Rather than bill their customers explicitly for 50% of the profits on trades executed by the $2.00 brokers, which was their agreement, the $2.00 brokers billed their customers for $.03 for each share they traded on profitable trades. This was the "mathematical equivalent" of 50% of the profits on a successful trade for 1/8 point profit, which was the profit that flippers would generally take. For example, if a $2.00 broker buys and sells 10,000 shares for 1/8 point profit, and has a 50% profit arrangement with his customer, he will receive $625.00 less trading expenses and fees on the trade, or approximately $600.00. If he bills his customer $.03 per share traded (or $3.00 per hundred shares), he will receive the "mathematical equivalent" of this 50% interest, because $.03 per share with 20,000 traded shares traded equals $600.00.

39. The conspirators preferred $2.00 brokers to utilize this misleading billing practice because it concealed the illegal profit sharing relationship between the $2.00 brokers and their customers. This billing practice made it appear that the brokers were billing a set rate base on the volume of shares traded — $.03 per share, or some other formula — and not sharing profits with their customers, which the conspirators knew was illegal.

40. Present at the Market Performance Committee meeting on January 15, 1992 were the following members, officials and staff of the NYSE: Messrs. Stone, Bocklet, Chapro, Fernandez, Gallagher, Greason, Jenkins, Kann, Lipton, McCann, McMahon, Meehan, Pizzolato, Robbins, Rosenblatt, Saladini, Scavone, Shields, Seigel, Cashin, Beyda, Arthur O. Harris, Lederer, Lombardo, Siemer and Ms. Allen and Ms. Cutler.

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41. McSweeney's testimony before the SEC on January 13, 1999 that there was an "agreement" among those present at the January 15, 1992 meeting that profit sharing was legal was untrue. Arthur O. Harris, who is a Vice President of the NYSE responsible for member trading in the Division of Surveillance, was present at this meeting and Harris knew that a 50/50 profit sharing arrangement was a violation of Section 11(a)(1) and Rule 11a-1 and was illegal.

42. Despite the "belief" he provided at the meeting of January 15, 1992, McSweeney was well aware that it was improper for a floor broker to share 50% of the profits in an account with his customer despite how it was billed. Indeed, Rule 352(c) expressly prohibited this practice. The reason he expressed the "belief" that it was "appropriate" for a broker to share profits in a customer's account was that he knew his superiors, the co-conspirators, Kwalwasser and Grasso, wanted this practice to continue, because it was generating substantial income for the NYSE and its members, including members who were not $2.00 brokers, and was increasing substantially the daily volume of trading on the NYSE.

43. On January 16, 1992 Susan G. S. Cutler, who was present at the January 15, 1992 meeting with McSweeney, sent a memorandum concerning the January 15, 1992 meeting to Grasso and Kwalwasser, among others. Kwalwasser and Grasso, together with the NYSE itself, once again confirmed the phony "finding" that profit sharing by a $2.00 broker in his customer's account did not result in an "interest in an account", and was appropriate.

44. The conspirators also made efforts to conceal what was occurring from the public and government regulators,

because they were well aware it was illegal. The January 16, 1992 memorandum to Grasso and Kwalwasser, relating to the January 15, 1992 meeting, from Ms. Cutler, stated that matters relating to the internal review of flipping by the NYSE (which concluded that profit sharing arrangements were entirely appropriate) could produce, if distributed in an "information memo" to NYSE members — which was the ordinary manner of communicating with the membership — "unwarranted media attention". The January 16, 1992 memorandum stated that the best manner to inform the membership of the legality of flipping — in return for which brokers could receive the "mathematical equivalent" of 50% of the profits generated by his trades — was to hold "information sessions" with the $2.00 brokers. These "information sessions" thereafter occurred and word was further spread among the membership that flipping for a share of the profits was "appropriate". While the conspirators disseminated, and caused to be disseminated, throughout the NYSE their approval of the practice of flipping for a share of profits in "information sessions", they were careful not to expressly place anything in writing about this approval, which they knew was illegal. For example, a memorandum prepared by the NYSE of the January 15, 1992 meeting did not explicitly reflect what had occurred at the meeting as much later testified to by McSweeney in paragraph 38. Not a word appears in this memorandum with respect to McSweeney's "belief that compensation [one-half the profits of trading] is appropriate." Moreover, on one occasion when a $2.00 broker, Michael Frayler, mentioned on the floor in the presence of a NYSE official that he was flipping for a 70% share of the profits, the official, William Johnston, said, "I didn't hear that". Since 1996 William Johnston has been

President of the NYSE. At the time that Frayler informed Johnston that he was flipping for a 70% share of the profits, Johnston was the non-executive vice chairman of the Board of Directors of the NYSE.

45. In 1991 and 1992 the conspirators never sought advice from the United States Securities and Exchange Commission ("SEC"), the governmental agency responsible for interpreting the securities laws and regulating the NYSE's conduct, as to the SEC's interpretation of Section 11(a) and Rule 11a-1, although representatives of the NYSE were in touch with the SEC on a regular basis. The conspirators did not do so because they already knew that profit sharing, no matter how it was billed, was in violation of law and that the SEC would so advise them, and demand that the flipping cease, which would have caused the NYSE to lose enormous amounts of money it was earning as transaction fees associated with the flipping, and would cause other member firms which were clearing the many trades of the flippers to lose this business.

46. On March 11, 1992 another meeting of the Market Performance Committee was held, attended by the conspirators, McSweeney and Kwalwasser, among many others, including members of the NYSE and other NYSE officials. Once again, McSweeney and Kwalwasser provided the NYSE "view" to all present that flipping for a share of profits was a proper trading strategy. On March 13, 1992 Susan G. S. Cutler submitted a Memorandum of the March 11, 1992 meeting to Grasso, who once again approved the NYSE's "view" that flipping for a share of the profits was "appropriate".

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47. Prior to the March 11, 1992 meeting someone at the NYSE who actually believed the conspirators were acting in good faith, and really had the views they were expressing, proposed to address in an information memo to be sent to the entire membership the issue of "brokers' financial interest in accounts for which they engage in trading for eights", which related to the issue of profit sharing as expressed by McSweeney at the January 15, 1992 Market Performance Committee meeting. As the conspirators were aware that such a memo would be evidence that they were aware that $2.00 brokers were flipping or trading for eights and sharing profits in those trades, no such memo was ever sent to the membership.

48. The co-conspirator Kwalwasser has testified before the SEC about his asserted "belief" that it was legal for a floor broker to share profits with a customer. He testified as follows on January 26, 1999:

> "Q. Did you have a view at or around January of 1992, if there was an agreement between the broker and the customer that the broker would be paid based on a percentage of the profits? Would that be a violation of 11(a), Section 11(a)?
>
> A. Are you presenting this as a hypothetical?
>
> Q. At the time did you establish a view at that time?
>
> A. *It's my consistent view* that when Congress said 'for your own account,' they meant 'for your own account', and merely getting any merge of profits from a transaction would not create an account that was encompassed by Section 11(a)."

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Since August of 1998, Richard Lindsey said that the Commission viewed it otherwise, we have taken the position that it's otherwise and will vigorously enforce that interpretation.

MR. PITT [counsel for the NYSE]: And for the record, on August 21, 1998 which is, I believe, the date of the letter, who was Mr. Lindsey?

THE WITNESS: Mr. Lindsey was the director of the division of market regulations of the Securities and Exchange Commission. And to the best of my knowledge, he still is.

Q. So based on your view in 1992, January of 1992, if there was a preestablished agreement that the broker would be getting a percentage of the profits that is not a violation of Section 11(a)?

A. That's correct." (Tr. 107-08) (Emphasis Added)

49. Kwalwasser also testified that he related his "view" to whoever sought it over the years. This resulted in the dissemination of this "view" to the membership over the years.

50. At the time that Kwalwasser gave this testimony Kwalwasser knew that a $2.00 broker sharing profits with a customer of course created an "interest in the account", and was illegal. Kwalwasser's "view" in 1991 and 1992 was the product of his desire and that of the other conspirators that the illegal practice of flipping and sharing in profits continue.

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51. Kwalwasser's testimony that profit sharing by members of the NYSE was not in his "view" a violation of the law directly contradicted NYSE Rule 352(c) which barred members from sharing profits with their customers. During his SEC testimony, when he testified that the NYSE took the position that floor brokers could legally share profits with their customers, Kwalwasser was confronted by the SEC with this NYSE rule. Kwalwasser attempted to explain away Rule 352(c) by testifying that the NYSE's definition of "customer" in this rule did not include broker dealers, even though broker dealers were in fact customers of floor brokers. When questioned by the SEC on January 28, 1999 with respect to his "interpretation" that "customer" does not include "customer" within the meaning of NYSE Rule 352(c), which expressly prohibited a member from sharing profits with his customer, Kwalwasser stated that Rule 352(c) was not drafted correctly. He gave the following brazenly false testimony, designed to cover-up his involvement in the conspiracy:

> "One of the problems before the middle 80's, there weren't a lot of lawyers at the Exchange. Some of the rules are not as artfully drawn as they may have been." (Tr. 344)

52. Grasso has also acknowledged in writing his approval from 1991-1998 of the practice of flipping for a share of profits by $2.00 brokers, and the fact that it was common at the NYSE. In a letter to the SEC, dated October 7, 1998, Grasso acknowledged that floor broker sharing of profits with their customers was "not uncommon" at the NYSE, and stated further that:

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> "This position was consistent with . . . the Exchange's *understanding* that compensation based on the profitability of trading did not, in and of itself, create an ownership interest in an account." (Emphasis Added)

53. Grasso knew or should have known that a floor broker receiving any share of the profits from an account had an "interest" in such an account in violation of the laws and rules outlined in paragraphs 19-23 above. He also knew or should have known that NYSE Rule 352(c) prohibited members from sharing profits with their customers. Grasso nevertheless allowed, approved and encouraged the practice of flipping and profit sharing from 1991-1997 because he wanted the practice to continue.

54. Grasso's letter to the SEC of October 7, 1998, as well as Kwalwasser's SEC testimony of January 26, 1999, was designed to make it appear that the conspirators had acted in good faith without criminal intent when they approved profit sharing arrangements in 1991 and to justify and cover-up their violations of the law and the rules they were charged with investigating and enforcing.

55. The co-conspirator, McNamara, has also testified before the SEC and elsewhere that it was his view, as a person who was responsible for rule and law interpretation with respect to this subject, that neither the rules nor laws prohibited profit sharing arrangements between floor brokers and their customers as long as such arrangements were characterized as "commissions". The other conspirators used McNamara to draft certain documents relating to their "interpretation" that profit sharing arrangements were proper.

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McNamara drafted these documents in an ambiguous fashion so as to obfuscate the truth. Thus, rather than state in 1991 in a memo explicitly that he and the other conspirators informed members of the NYSE that they could share profits, McNamara wrote the following, on behalf of a NYSE Committee which was reviewing this issue:

> "The Committee notes that if a broker, in representing 'trading for eighths' orders or other orders, is compensated for his services based on the profitability of transactions in such a way that he becomes, in effect, a 'partner' with his customer in the trade, such a broker may then become subject to the restrictions contained in Section 11(a) of the Securities Exchange Act as to proprietary trading by members of a securities exchange. The Committee further notes, however, that commissions are freely negotiable under federal law, and that it may be very difficult to determine when a broker's compensation for his services is such that he ought to be viewed as a 'partner' in a transaction. The Committee concludes that any such determination may involve a review of records over a period of several months with a view toward establishing a broker's 'intent' and that such a matter is, in any event, within the purview of the Exchange's Regulatory Group and not the Committee".

This was meant to be and was double-talk designed to obfuscate the truth. McNamara has since testified that this paragraph was meant to communicate the NYSE's view that profit sharing arrangements were a legitimate form of

commission and did not violate Section 11(a). This written paragraph does not say this. The paragraph was intentionally drafted in an ambiguous manner to permit subsequent deniability of the profit sharing practices at the NYSE. Indeed, the last sentence of the paragraph purports to defer the entire question to another department of the NYSE. There was no such deferral of the issue at this time. Rather, the conspirators informed members, but not in writing, that a floor broker's sharing of profits with his customer was proper.

56. McSweeney's "belief", Kwalwasser's "consistent view" and Grasso's "understanding", as well as McNamara's view, that flipping for a share of profits was "appropriate" was disseminated throughout the NYSE by themselves and others acting for them so that it became common knowledge on the floor that the NYSE approved of flipping for a share of profits, and that NYSE rules did not bar the practice. Indeed, when Brian McNamara was questioned about the dissemination of this "view" over the years, which he admitted he helped formulate, he testified under oath that he saw no reason that the floor broker members of the NYSE would not have been aware of the NYSE's "position" on this issue, which dissemination would necessarily have occurred by word of mouth, as the conspirators were careful not to disseminate it in an information memo.

57. From 1991 to 1993 the conspiracy to violate Section 11(a) and Rule 11a-1 was very successful. By the beginning of 1993 the flipping and profit sharing activity on the floor had grown enormously and had earned the NYSE and its members, including non-$2.00 broker members, many millions of dollars in fees which they would not otherwise have earned.

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58. In this period of time someone at the NYSE who was honest prepared a draft of an information memorandum to be sent to the membership with the following language:

> "A member handling an order as to which a profit sharing arrangement exists would be considered to be handling a proprietary order and must execute the order in compliance with Section 11(a) of the Securities Exchange Act and the rules promulgated thereunder."

This language accurately stated the law. The draft was never issued to the membership because the conspirators wanted the illegal trading to continue.

59. In 1993, some members of the NYSE continued to complain justifiably to the conspirators that flipping violated the law and NYSE rules, and that members of the public were being defrauded, as they were not obtaining the best prices for their orders because the best prices were going to flippers and their customers. These members expressly informed some of the conspirators that flipping "interferes unduly with the execution of public orders, and that publicity about the practice could adversely affect perceptions of the integrity of the Exchange market place". As a result of these complaints, and in order to placate the people making them, the conspirators were forced to "review" once again the practice of $2.00 brokers sharing in the profits of flip trades executed for their customers.

60. A Committee, called the Advisory Committee on Intra-Day Trading Practices, was appointed by the NYSE to accomplish this review. The Committee was comprised of

members and representatives of member firms of the NYSE. The Committee members were the following: George R. Balduzzi, Director — Equity Trading, First Boston Corporation; J. Gary Burkhead, President, Fidelity Management & Research Co.; James M. Duryea, President, J.M. Duryea, Inc.; Peter W. Jenkins, Principal, Scudder, Stevens & Clark; David L. Luke, III, Chairman of the Board, Westvaco Corporation; Joseph A. Mahoney, Managing Partner, Adler, Coleman & Co., L.P.; Terence S. Meehan, Managing Partner, M.J. Meehan & Co.; Michael D. Robbins, Independent Broker; Donald Stone, Chairman, Merrill Lynch Specialists, Inc.; Joel M. Surnamer, Senior Partner, Surnamer, Weissman & Co.; and Daniel Tandy, Vice President, Roulston Research.

61. At this time the Committee conducted written surveys of the extent of the flipping activity on the floor of the NYSE. The written survey data revealed that flipping and profit sharing were ubiquitous at the NYSE. The Committee determined that approximately Two Hundred and Thirty (230) $2.00 brokers were engaging in flipping on the floor with respect to 205 different stocks. This accounted for millions of shares being transacted on the floor of the NYSE through flip trades every day. The Committee also determined that among the customers or "partners" of these $2.00 brokers were many other members of the NYSE, member organizations of the NYSE, non-member broker dealers, specialists of the NYSE (in their non-specialty stocks) and clerks of members. These members, member organizations, non-member broker dealers, specialists and clerks of members agreed with floor brokers to share profits in their accounts with the $2.00 brokers executing the trades, or, in effect, to become partners with the floor brokers. Of the

40 specialis units on the floor (specialists operated and managed the auction market in individual stocks at different places on the floor) 36 reported to the Committee that the stocks on which they specialized were being flipped. Essentially, a large part of the entire community of the NYSE was engaging or assisting in flipping by $2.00 brokers for a share of the profits, from which they all profited significantly.

62. The Advisory Committee on Intra-Day Trading Practices recommended to the NYSE that new rules be implemented prohibiting this illegal practice, which members of the Committee equated with proprietary trading, or trading for one's own account. One of the Committee members informed Kwalwasser, during one of its meetings, that a $2.00 broker who shares in the profits of his trades is not functioning as a pure "agent", which the law requires. Kwalwasser ignored the complaint, even though he knew it was valid. If the recommendations of the Committee were implemented, flipping and profit sharing would have been for all practical purposes halted on the floor.

63. In a successful effort to continue the conspiracy, the NYSE ultimately rejected most of these recommendations and the illegal flipping and profit sharing continued. The conspirators also discarded and caused to be discarded, as part of their cover-up, the raw survey data on flipping received by the Advisory Committee on Intra-Day Trading Practice referred to in paragraph 61. Brian McNamara has testified that the data, which had been subpoenaed, was probably misfiled. The data included the actual identities of the flippers.

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64. In 1993, despite the knowledge of the conspirators that federal laws and rules were being repeatedly and systematically violated, the conspirators continued their cover-up of these violations by continuing their concocted and fraudulent "interpretation" of the term "interest in an account". They thus continued to inform the members of the NYSE, directly or indirectly, that the practice of profit sharing was proper and that the question of whether someone had an "interest" in an account was one of his "intent", and that as long as he did not intend to become a partner in an account, he could share profits with the customer.

65. In this period Kwalwasser, in order to make certain that no one would interfere with the violations of the law, instructed the Division of Surveillance of the NYSE that it should not even analyze compensation agreements between $2.00 brokers and their customers.

66. Kwalwasser, McNamara, McSweeney and Grasso participated in both the 1991 and 1993 NYSE reviews of floor broker flipping. They falsely informed other Committee members in both reviews and through them all members of the NYSE, that their sincere "view", "opinion" and "understanding" was that sharing in profits did not confer an "interest in an account" on the $2.00 broker and that a broker could still be an agent in a transaction which he was receiving a portion of the profits from the transaction. Throughout the years these conspirators continued to repeat these "interpretations" to whoever would consult with them. Through these statements by the conspirators throughout the years, it became common knowledge on the floor that, in the words of Grasso, in his October 7, 1998 letter to the SEC,

"compensation based on the profitability of trading did not, in and of itself, create an ownership interest in an account" and that as a result such arrangements at the NYSE were, in Grasso's words, "not uncommon".

67. The conspirators' statements were designed to, and did in fact, mislead numerous $2.00 brokers into believing that flip trading and profit sharing arrangements were in conformity with the law and the rules when they were not.

68. The motivation of the conspirators to continue to falsely inform the $2.00 brokers that sharing arrangements did not violate the law and rules, besides initially generating substantial fees for the NYSE, was a desire to increase the daily volume of trading activity on the NYSE, which, in turn, was used by the defendant, Grasso, and the NYSE to tout to the public the breath, scope and liquidity of the NYSE, as compared to other exchanges which were in competition with the NYSE to list new securities for trading. During the conspiracy, illegal flipping activity accounted for millions of shares being transacted on the floor on a daily basis. Moreover, the more shares traded by $2.00 brokers, the more fees were earned by non-$2.00 broker members of the NYSE which were also involved in the trades, such as clearing firms. Member firms which cleared flip trades were paid substantial fees for this service. Millions of dollars were earned over the years by these clearing members with respect to flipping trades. As Grasso's position as a member of the Board of Directors of the NYSE was dependent upon his election by the membership of the NYSE, the more money the members made, the more likely that they would vote for the status quo and maintain Grasso in his position.

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69. During the conspiracy to violate the federal securities laws, the conspirators were at all times careful not to place their "belief" concerning profit sharing arrangements in writing, knowing that it was fraudulent and could be used to incriminate them if the illegal practices came to light. For example, they never expressly stated in any information memorandum distributed to the members that $2.00 brokers could properly receive a 50% share of profits — or any share of the profits at all — on trades they executed. The only reference to this in any document was clouded in ambiguities, such as the document drafted in 1991 by the defendant McNamara, referred to in paragraph 55 above, concerning efforts to establish a broker's "intent", which was never sent to the membership. Further even the drafting of the 1993 Report of the Advisory Committee on Intra-Day trading made no reference that the 230 brokers who were flipping in 1993 were doing so for a share of the profits. It was only when SEC and the United States Attorney's Office for the Southern District of New York (USAO) began an investigation into the profit sharing arrangements that the conspirators began to give the explicit testimony about their prior "interpretations" referred to in this complaint, and Grasso admitted that profit sharing arrangements were "not uncommon" at the NYSE.

70. During the conspiracy, and up until the time that the United States Attorney's Office for the Southern District of New York learned on its own what was occurring at the NYSE, the conspirators never explicitly consulted with the SEC with respect to their "interpretation" of the law, despite the fact that it was the SEC's responsibility and duty to provide such an interpretation and despite the further fact that the issue of the legality of this practice was repeatedly

raised over the years at the NYSE. The conspirators failed to consult with the SEC because they were well aware of what the law was. Indeed, NYSE Rule 352(c) expressly prohibited the practice of profit sharing between members of their customers. During his SEC testimony Kwalwasser testified that the first time the NYSE asked the SEC for guidance with respect to this issue was March 1998, which was months after the conspiracy was uncovered by the USAO (Tr. 112).

JOHN AND MARK SAVARESE BEGIN A FLIPPING ARRANGEMENT WITH OAKFORD

71. In 1993, after the conspirators informed members of the NYSE, directly and indirectly, that profit sharing arrangements were legal, and did not create an interest in an account, John and Mark Savarese, justifiably relying upon these representations, began a flipping relationship with the Oakford Corporation, a non-member broker dealer, under which they were paid as a commission approximately 90% of the profits on flip trades they executed for Oakford. As Mark and John Savarese were then employed by MFS, the Oakford trading was executed through MFS. Almost all of the commissions earned through the Oakford trading were passed through MFS to Mark and John Savarese. Mark and John Savarese's arrangement with Oakford was only a part of MFS' floor brokerage business. MFS had many other customers besides Oakford. For the year 1997, MFS received approximately $3.1 million in commissions.

72. John and Mark Savarese's arrangement with Oakford was made in reliance on what the conspirators informed Mark and John Savarese directly and indirectly concerning the

propriety of this trading and billing activity, and the fact that it was not violative of any rules or securities laws. If they had any idea that these representations were false, they would not have engaged in this activity. If they had any idea their conduct with respect to profit sharing violated laws and rules, they would not have engaged in it. John and Mark Savarese also took comfort as to the legality of flipping and profit sharing because it was occurring openly and notoriously on the floor on a daily basis, and it was common knowledge that flipping for a share of profits was permissible at the NYSE. Indeed, Richard Grasso stated in his October 7, 1998 letter to the SEC that profit sharing at the NYSE was "not uncommon" because of the NYSE's "understanding" that it did not create an ownership interest in an account.

73. John and Mark Savarese were of course well aware that they were not permitted to trade for their own account or for an account in which they held an interest without its approval of the NYSE. Based upon what the conspirators had informed, directly or indirectly, members of the NYSE, however, they did not believe that they had an interest in the Oakford account.

74. John and Mark Savarese engaged in flipping through MFS for Oakford from June 1993 to February 25, 1998, when the NYSE summarily suspended John and Mark Savarese, and charged them in a disciplinary proceeding with trading for their own account based on their profit sharing arrangement with Oakford.

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THE DEFENDANT PERMITS DISCRETIONARY TRADING PRACTICES BY ITS MEMBERS WITHOUT INFORMING THEM THEY ARE ILLEGAL

75. On October 21, 1999 Kwalwasser gave the following testimony before the Hon. Jed Rakoff, United States District Judge for the Southern District of New York, with respect to the NYSE's interpretation of the meaning of discretionary trading, which appears in the following portion of Judge Rakoff's opinion and order of December 13, 1999:

> Q: [A] floor broker is on the floor, he sees something he likes, calls his clerk . . . the clerk calls upstairs to another clerk with the customer, and tells that clerk upstairs, clock me up an order . . . And then . . . the floor broker executes the order. Is that a violation of Section 11?
>
> A: That is not.
>
> Q. Let us assume that the clerk upstairs had absolutely no meaningful exchange at all with the floor broker's clerk on the floor. Is that a violation of Section 11(a)'s discretionary prong? . . .
>
> A. That would be in complian[ce].
>
> THE COURT: Supposing the clerk upstairs had a standing direction from his boss, that whatever the floor broker tells him to do he should do. Would that then be a violation?
>
> That would not be a violation. . . .

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THE COURT: And you are saying that [the Exchange's] interpretation of the word discretion was that if the customer says . . . to the floor broker, "you can trade anything you want in any amount you want at any time you want, and all you have to do is call into my clerk who will have a standing order from me to automatically . . . clock an order when you call . . . ," that would not be an exercise of discretion in violation of the statute or the rule as [the Exchange] . . . interpret [ed] it, at the relevant time?

A: That's correct.

Kwalwasser also gave the following testimony at this hearing:

> Q. Let me pose a final hypothetical, and ask your opinion as to whether this violates any part of Section 11A.
>
> A floor broker has 90 percent interest in an account, in the profitability of an account. He has an arrangement with his customer whereby the floor broker gets to choose what stocks, what price and at what time to trade in that account. Each time the floor broker wants to execute that trade, however, he makes a call upstairs to insure that they have clocked the trade.
>
> Do you see a violation of Section 11A?
>
> A. No.

Tr. 10/21/99, at 285-87, 290.

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76. With very few exceptions, all of John and Mark Savarese's trading methodology while employed by MFS was within the proper scope of trading as outlined by Kwalwasser in this testimony.

77. While it is obvious to one trained in the law that Kwalwasser's testimony is nothing less than an admission that the NYSE deliberately circumvented the law against discretionary trading (Judge Rakoff found that the NYSE's interpretation made a "mockery of the ordinary meaning of 'discretion' and creates a convenient escape from the meaningful enforcement of Section 11(a) and Rule 11a-1"), John and Mark Savarese, and the plaintiffs, did not know this, as they did not know that the NYSE's position with respect to profit sharing was also fraudulent.

THE CRIMINAL AND SEC INVESTIGATIONS BEGIN

78. In late 1997 the United States Attorney's Office for the Southern District of New York and the SEC began an investigation of flipping at the NYSE. These Government agencies took the position, obvious to any trained lawyer, that profit sharing arrangements conferred an "interest in the account" upon the $2.00 broker, which implicated the laws and rules referred to in paragraphs 18-23, and that the methodology of trading outlined by Kwalwasser in paragraph 76 was illegal discretionary trading.

79. As John and Mark Savarese were then engaged in flipping for Oakford, through their employment with MFS, their conduct, as well as the conduct of the plaintiffs, became a subject of the investigation, together with the conduct of many

other $2.00 brokers who had similar relationships with their customers. The defendant's conduct also became a subject of this investigation because of its "interpretation" of the law.

80. In connection with the investigation, the Government met with the conspirators, Kwalwasser, McSweeney and McNamara, and other representatives of the NYSE in late November 1997. The NYSE, in an effort to conceal and cover-up its own illegal activities relating to the flipping, and to curry favor with the authorities in an effort to prevent its own indictment, provided the United States Attorney's Office and the SEC with false, misleading and inaccurate information about its own involvement in the floor brokers' trading practices for accounts in which they were sharing profits, and made material omissions of material facts in their meetings with the Government. The NYSE sought to cover-up its own participation in the conspiracy by falsely informing the SEC and the United States Attorney's Office through its representatives that the great bulk of Mark and John Savarese's flipping activity for Oakford was not approved by the NYSE, and by concealing its own full involvement over the years in approving flipping arrangements involving profit sharing and in interpreting the rules with respect to discretionary trading in a way that permitted it. These false statements and omissions helped cause the arrest of John and Mark Savarese and others on February 25, 1998 for a violation of Section 11(a) and Rule 11a-1 based upon their trading for Oakford, and contributed to the institution of SEC action against John and Mark Savarese on February 25, 1998, together with MFS. No criminal charges were ever brought against the plaintiff, Marco Savarese, or the plaintiff, MFS, and no SEC action was ever instituted against Marco Savarese, the plaintiff.

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81. On February 25, 1998 the NYSE summarily suspended Mark and John Savarese under NYSE Rule 475(b).

82. Following the arrest of John and Mark Savarese on February 25, 1998 and their later indictment for trading for their own account on the floor based on their profit sharing arrangement with Oakford, which they did through MFS, and for discretionary trading based upon their methodology of trading for Oakford, the United States Attorney's Office became aware of some of the details of the defendant's various "interpretations" of the law over the years at the NYSE. This raised questions with respect to John and Mark Savarese's guilt on the criminal charges. As a result of this, Mark and John Savarese were permitted to plead guilty to relatively minor allegations of discretionary trading relating to a few instances over the course of many years in which they executed orders on behalf of Oakford without notifying Oakford in advance.

83. Concerning the criminal charges that John and Mark Savarese knowingly traded for an account in which they held an interest by sharing in the profits with Oakford, the Government, when it became aware of the full extent of the defendant's conduct, did not require that either Mark or John Savarese admit that he engaged in this conduct with the requisite *mens rea*, and neither Mark or John Savarese admitted to this charge.

84. In the summer of 1998 the SEC dismissed its Complaint against MFS. On March 30, 2000 the SEC reinstituted a different Complaint against MFS, which MFS is defending.

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THE REAL GUILTY PARTY IS IDENTIFIED BY THE SEC

85. Long after the arrests of John and Mark Savarese on February 25, 1998, in a letter to the conspirator, Grasso, dated September 14, 1998, the Director of Compliance Inspections and Examination of the SEC stated that an SEC investigation determined that:

> ". . . through . . . improper restrictive rule interpretation, the NYSE has allowed independent floor brokers to disregard applicable securities laws and Exchange rules."

86. The NYSE "allowed independent floor brokers to disregard applicable securities laws and Exchange rules", as stated in the September 14, 1998 SEC findings, by informing them, and causing them to be informed, knowingly and negligently, that they could legally share profits with their customers and by further informing them that they could permissibly circumvent the rules and law on discretionary trading. The key words in the SEC's findings are "improper rule interpretation" by the NYSE. These "improper rule interpretations" were related to the membership, including Mark and John Savarese, who relied upon them to their detriment.

87. On June 29, 1999 the SEC instituted administrative proceedings against the NYSE for failure to enforce compliance with Section 11(a) and Rule 11a-1. Specifically, the SEC found that "from at least 1991 through December 1997, the NYSE, without reasonable justification or excuse, failed to enforce compliance by independent floor brokers

with Section 11(a) and Rule 11a-1 of the Exchange Act, and NYSE Rules 90, 95 and 111, governing floor trading."

88. These findings were only partially true. The NYSE and the individual conspirators not only "failed to enforce compliance" with these laws. They actively, and successfully, sought to encourage violations of them by unwitting $2.00 brokers, and to cover-up their own involvement in these crimes. Judge Rakoff, who presided over the criminal and SEC action, has characterized the NYSE's enforcement of Section 11(a) and Rule 11a-1 as "anemic" and "anorexic". Even these words understate the guilt of the NYSE for a successful conspiracy to violate the federal securities laws.

THE ARBITRARY AND ILLEGAL TERMINATION OF MFS' STATUS AS A MEMBER ORGANIZATION AND THE INTENTIONAL DESTRUCTION OF ITS BUSINESS

89. Section 19(g) of the Exchange Act required the defendant to abide by and enforce its own rules. In an illegal effort to curry favor with the United States Attorney's Office to avoid its own indictment, the defendant deliberately violated its own rules and this statute. NYSE Rule 475(a) provides as follows:

> "Except as provided in subsection (b) of this Rule, the Exchange shall not prohibit or limit any person with respect to access to services offered by the Exchange or any member or member organization thereof unless the Exchange shall have notified such person in writing of, and shall have given

such person, upon not less than 15 days prior written notice, an opportunity to be heard upon, the specific grounds for such prohibition or limitation. The Exchange shall keep a record of any proceeding pursuant to this Rule. Any determination by the Exchange to prohibit or limit any person with respect to access to services offered by the Exchange or a member or member organization thereof shall be supported by a statement setting forth the specific grounds on which the prohibition or limitation is based."

90. Rule 475(b) provides as follows:

"The Exchange may summarily -

(i) suspend a member, member organization, allied member, approved person, or registered or non-registered employee of a member or member organization who has been and is expelled or suspended from any other self-regulatory organization, as defined in Section 3(a)(26) of the Securities Exchange Act of 1934, or barred or suspended from being associated with a member or any such self-regulatory organization provided, however, that any such summary suspension imposed by the Exchange shall not exceed the termination of the suspension imposed by such other self-regulatory organization on such member, member organization, allied member, approved person, or registered or non-registered employee;

(ii) suspend a member or member organization who is in such financial or operating difficulty that the Exchange determines and so notifies the Securities and Exchange Commission that the member or member organization cannot be permitted to continue to do business as a member or member organization with safety to investors, creditors, other members or member organizations, or the Exchange;

(iii) limit or prohibit any person with respect to access to services offered by the Exchange if subparagraph (i) or (ii) of this subsection is applicable to such person or, in the case of a person who is not a member or member organization, if the Exchange determines that such person does not meet the qualification requirements or other prequisites for such access and such person cannot be permitted to continue to have such access with safety to investors, creditors, members, member organizations, or the Exchange.

Any person aggrieved by any such summary action shall be notified in writing of, and shall be promptly afforded an opportunity to be heard by the Exchange upon, the specific grounds for such summary action. The Exchange shall keep a record of any proceeding pursuant to the Rule. Any determination by the Exchange with respect to such summary action shall be supported by a statement setting forth the specific grounds on which the summary action is based. The Commission,

by order, may stay any such summary action in accordance with the provisions of the Securities Exchange Act of 1934."

91. On February 25, 1998 the NYSE, despite the fact that MFS was a member organization of the NYSE in good standing, and without notice to MFS, declared MFS' membership automatically terminated, and imposed a group boycott by its members and member organizations against MFS, preventing NYSE members and member organizations from doing business with MFS, and preventing MFS from using the services of the NYSE. To effectuate the boycott, the defendant cut all of MFS' phone lines on the floor preventing it from communicating with its customers. The NYSE thus, contrary to the language of Rules 475(a) and (b), prohibited MFS from having access to the services offered by the NYSE. As a result of defendant's conduct, MFS was unable to service its customers on the floor and, consequently, immediately lost them to its competitors.

92. The NYSE unilaterally terminated MFS' status as a member organization without affording MFS notice and/or a hearing required by Rule 475 because the defendant was aware that such a hearing might expose its own criminal conduct and the criminal conduct of its co-conspirators, as outlined in this Complaint. The last thing the defendant sought at this time was disclosure of the fact that its enforcement of the law had been, in the words of Judge Rakoff, "anemic" and "anorexic".

93. In effect the defendant summarily suspended MFS as a member organization without explicitly stating that it was doing so. It did this because it was aware that such a summary

suspension would have continued MFS' status as a member organization which would have enabled MFS to immediately hire another member to conduct its business on the floor, which would have saved its business. Further, the defendant did not summarily suspend MFS because such an action would have also triggered the provision of Rule 475(b) and require the NYSE to grant MFS a prompt hearing on the allegation. Indeed, when the SEC sued MFS, it accurately stated in its Complaint that MFS was "summarily suspended" as a member organization in February 1998 by the NYSE.

94. To effectuate its purpose of destroying MFS' status as a member organization without having to afford MFS with the due process hearing required by Rule 475, which might have exposed the defendant's criminal conduct, the defendant engaged in an elaborate and fraudulent scheme to confuse the plaintiffs about what was happening to them and to seemingly justify its actions in destroying MFS' business.

95. Immediately after the termination, the defendant informed plaintiffs that the suspensions of Mark and John Savarese on February 25, 1998 automatically terminated MFS' status as a member organization. The defendant also took the position, which it also knew was unjustified, that because MFS was no longer a member organization, it was not entitled to the protection of Rule 475, and therefore was not entitled to any hearing. The defendant took this position even though it did not assert that the 100% owner of MFS, the plaintiff, Marco Savarese, did anything wrong whatsoever, or indeed, that MFS did anything wrong, and notwithstanding the further fact that plaintiffs informed defendant that plaintiffs' entire business was being destroyed as a result of the automatic termination.

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96. If such a hearing were allowed, as it should have been under Rule 475(b), MFS would have been able to establish its own lack of culpability, as well as the lack of culpability of its employees on all but the most insignificant of allegations, and would have further established the defendant's conspiracy as outlined in this Complaint. This was in fact the reason that the NYSE insisted that MFS was not summarily suspended, which would have required a hearing under Rule 475(b), but was rather "automatically terminated", which afforded MFS no rights whatsoever. The NYSE was motivated by a desire to make certain that its own criminal involvement remained concealed.

97. The NYSE engaged in this subterfuge to deprive MFS of its rights based on its contract with the NYSE and its rights under the NYSE rules and the Exchange Act.

98. The NYSE further attempted to effectuate this scheme by informing MFS immediately after its unlawful termination as a membership organization that it lost its status as a membership organization because of its summary suspensions of John and Mark Savarese as members of the NYSE under Article 1, Section 3(i) of the NYSE Constitution, which states as follows:

> "The term 'member corporation' means a corporation, registered as a broker or dealer in securities under, unless exempted by, the Act, approved by the Board as a member corporation, at least one of whose officers or employees is a member of the Exchange, or which has the status of a member organization by virtue of permission given to it pursuant to the rules of the Exchange."

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99. The NYSE statement to MFS that this section of the Constitution *ipso facto* deprived MFS of its membership status and caused its automatic termination as a membership organization was false. The suspensions of Mark and John Savarese did not terminate their status as members of the NYSE, which memberships continued until September 1999, long after the events in question. Also, the president of MFS, the plaintiff, Marco Savarese, was himself an allied member of the NYSE.

100. Moreover, MFS maintained its status as a member organization independent of the status of Mark and John Savarese as members of the NYSE or as employees of MFS. MFS on February 25, 1998 had the status as a member corporation and organization by virtue of permission given to MFS pursuant to NYSE rules. Indeed, MFS beneficially owned an NYSE membership pursuant to an "A-B-C Agreement" which it had signed years before these events with Mark Savarese. Under the Agreement Mark Savarese's membership reverted to MFS if and when he ceased to be an employee of MFS, which occurred on the date he was suspended, February 25, 1998. This Agreement should have ensured that MFS remained a member organization notwithstanding the suspensions of its floor broker employees.

101. The plaintiffs were unaware in February and early March, 1998 of the defendant's bad faith, and did not know that the defendant was intent upon destroying its business notwithstanding the rules.

102. When the defendant declared MFS' status terminated and imposed the group boycott against MFS, MFS immediately complained to the defendant that defendant's actions were destroying its business.

103. The defendant's representatives then informed plaintiffs that MFS could easily substitute another NYSE member to support MFS' status as a member organization, and therefore save its business, by applying to the NYSE under Rule 312(f), which reads in part as follows:

> "The Exchange may, on the application of the directors or partners in a member organization whose sole Exchange member has died or ceased to be associated as a member therewith, permit, provided such action is consistent with the protection of investors and the public interest, such organization which otherwise continues to meet Exchange requirements, to have the status of a member organization for a period of 90 days from the date of the death of the member or on which the member has ceased, or shall be alleged to have ceased, to be associated as a member with such member organization."

104. MFS, believing the defendant was acting in good faith, and not realizing that the suspensions of John and Mark Savarese did not *ipso facto* terminate its status as a member organization, hired a lawyer and made an application on February 26, 1998 under Rule 312(f) in an effort to save its business.

105. Rule 312(f) did not apply to this situation because John and Mark Savarese did not cease to be associated as members by their suspensions and, in any event, MFS retained its status as a member organization nonetheless. However, because the NYSE informed MFS that it should

apply under Rule 312(f) to obtain continued status as a member organization under this rule, and MFS did not then understand that defendant was acting in bad faith, MFS made such an application. Its application was immediately denied by the defendant.

106. In denying MFS' application under Rule 312(f) to continue its status as a member organization, the defendant did not take the position that such permission would be against the public interest.

107. MFS also informed defendant that it had hired another existing member to conduct its brokerage business on the floor in place of John and Mark Savarese. The defendant informed MFS that it no longer had a brokerage business on the floor because it was no longer a member organization of the NYSE. After MFS' business was destroyed on the floor and after all its customers began to be serviced by MFS' competitors on the floor, representatives of the defendant informed plaintiffs that they could seek a review of the defendant's action with the defendant's Board of Directors. This was a further effort by defendant to attempt to cover its unlawful actions with a cloak of legality when none existed. By the time plaintiffs were allowed to make such an application, MFS' business was long destroyed.

108. This is the only time in the history of the NYSE that the NYSE acted in such a fashion. The reason that it acted in such a fashion was that it was intent upon destroying MFS' business without affording MFS rights under NYSE rules designed to protect member organizations.

109. Other actions of the defendant at this time against other member organizations of the NYSE which were identically situated to MFS and which were afforded the protection of Rule 475(b), also demonstrate defendant's bad purpose and unlawful acts against MFS.

110. For example, the defendant summarily suspended both John D'Alessio and D'Alessio Securities, Inc. on February 25, 1998 under Rule 475(b) and charged them with the same allegations with which John and Mark Savarese were charged by the defendant. John D'Alessio operated his floor brokerage business through D'Alessio Securities, Inc. John D'Alessio and D'Alessio Securities, Inc. also had a profit sharing arrangement with Oakford. John D'Alessio was also the only employee of his corporation and was the only member working on the floor for D'Alessio Securities. He thus had a very similar relationship to his corporation that Mark and John Savarese had to MFS. The NYSE did not claim, however, that D'Alessio Securities, Inc. automatically lost its status as a member organization of the NYSE by the suspension of John D'Alessio. Rather, the NYSE formally summarily suspended both the individual and the entity and afforded both the opportunity to have a prompt hearing with respect to the reason for the suspension under Rule 475(b). Thus, D'Alessio Securities, Inc. was given the right to a hearing under Rule 475(b), which MFS was deprived of because the defendant took the position that MFS automatically lost its membership status. D'Alessio was unable to force such a hearing at that time, however, because of pending criminal charges against him. No such charges were ever made against plaintiff, Marco Savarese, who was ready willing and able to insist on the hearing under

Rule 475(b). This was one of the reasons that the defendant concocted the false position that MFS automatically lost its membership by the suspension of John and Mark Savarese and that therefore MFS was not entitled to a hearing, that is, the defendant's belief that plaintiff, Marco Savarese, would insist on a hearing under Rule 475(b).

111. The inconsistent treatment between MFS and D'Alessio Securities, Inc. was a product of the defendant's desire to make certain that MFS' business was destroyed without recourse to MFS and without affording MFS a hearing in violation of the NYSE rules and the federal securities laws.

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COUNT ONE
ANTI-TRUST VIOLATION

112. All of the allegations of paragraphs 1-111 are hereby incorporated herein.

113. The defendant, NYSE, its members and member firms, among other co-conspirators, knowingly and willingly conspired and combined to unreasonably restrain trade and commerce by imposing a group boycott against the plaintiffs and by refusing to deal with them at the NYSE and by depriving MFS of access to the services and facilities of the NYSE, which has caused MFS damages in the approximate amount of $6,000,000.

COUNT TWO
BREACH OF CONTRACT

114. All of the allegations of paragraphs 1-113 are hereby incorporated herein.

115. As a result of its conduct the defendant breached its contract with plaintiff, MFS, causing MFS damages in the amount of $6,000,000.

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WHEREFORE the plaintiffs demand judgment against the defendant for treble damages in the amount of $18,000,000 and punitive damages in the amount of $50,000,000 on Count One and $6,000,000 on Count Two, together with prejudgment interest, attorneys' fees and costs.

Dated: New York, New York
July 27, 2000

s/ Dominic F. Amorosa
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APPENDIX E — STATUTORY PROVISIONS

UNITED STATES CODE
TITLE 15. COMMERCE AND TRADE
CHAPTER 1 — MONOPOLIES AND COMBINATIONS IN RESTRAINT OF TRADE

§ 1. Trusts, etc., in restraint of trade illegal; penalty (Sherman Act, Section 1)

Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared to be illegal shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding $10,000,000 if a corporation, or, if any other person, $350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

Appendix E

TITLE 15. COMMERCE AND TRADE
CHAPTER 2B — SECURITIES EXCHANGE
15 USCS § 78C (2002)
(Securities Exchange Act of 1934)

§ 78c. Definitions and application (Section 3)

(a) Definitions. When used in this title, unless the context otherwise requires —

* * *

(26) The term "self-regulatory organization" means any national securities exchange, registered securities association, or registered clearing agency, or (solely for purposes of sections 19(b), 19(c), and 23(b) of this title [*15 USCS §§ 78s*(b), (c), 78w(b)]) the Municipal Securities Rulemaking Board established by section 15B of this title [*15 USCS § 78o-4*].

* * * *

§ 78f. National securities exchanges (Section 6)

* * *

(b) Determination by Commission requisite to registration of applicant as a national securities exchange. An exchange shall not be registered as a national securities exchange unless the Commission determines that —

(1) Such exchange is so organized and has the capacity to be able to carry out the purposes of this chapter and to comply, and (subject to any rule or order of the Commission pursuant to section 78q(d) or 78s(g)(2) of this title) to enforce compliance by its members and persons associated with its members, with the provisions of this chapter, the rules and regulations thereunder, and the rules of the exchange.

(2) Subject to the provisions of subsection (c) of this section, the rules of the exchange provide that any registered broker or dealer or natural person associated with a registered broker or dealer may become a member of such exchange and any person may become associated with a member thereof.

(3) The rules of the exchange assure a fair representation of its members in the selection of its directors and administration of its affairs and provide that one or more directors shall be representative of issuers and investors and not be associated with a member of the exchange, broker, or dealer.

(4) The rules of the exchange provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities.

(5) The rules of the exchange are designed to prevent fraudulent and manipulative acts and

practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers, or to regulate by virtue of any authority conferred by this chapter matters not related to the purposes of this chapter or the administration of the exchange.

(6) The rules of the exchange provide that (subject to any rule or order of the Commission pursuant to section 78q(d) or 78s(g)(2) of this title) its members and persons associated with its members shall be appropriately disciplined for violation of the provisions of this chapter, the rules or regulations thereunder, or the rules of the exchange, by expulsion, suspension, limitation of activities, functions, and operations, fine, censure, being suspended or barred from being associated with a member, or any other fitting sanction.

(7) The rules of the exchange are in accordance with the provisions of subsection (d) of this section, and in general, provide a fair procedure for the disciplining of members and persons associated with members, the denial of membership to any person seeking membership therein, the barring of any person from becoming

associated with a member thereof, and the prohibition or limitation by the exchange of any person with respect to access to services offered by the exchange or a member thereof.

(8) The rules of the exchange do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this chapter.

(9) The rules of the exchange prohibit the listing of any security issued in a limited partnership rollup transaction (as such term is defined in paragraphs (4) and (5) of section 78n(h) of this title), unless such transaction was conducted in accordance with procedures designed to protect the rights of limited partners, including —

(A) the right of dissenting limited partners to one of the following:

(i) an appraisal and compensation;

(ii) retention of a security under substantially the same terms and conditions as the original issue;

(iii) approval of the limited partnership rollup transaction by not less than 75 percent of the outstanding securities of each of the participating limited partnerships;

(iv) the use of a committee of limited partners that is independent, as determined in accordance with rules prescribed by the exchange, of the general partner or sponsor, that has been approved by a majority of the outstanding units of each of the participating limited partnerships, and that has such authority as is necessary to protect the interest of limited partners, including the authority to hire independent advisors, to negotiate with the general partner or sponsor on behalf of the limited partners, and to make a recommendation to the limited partners with respect to the proposed transaction; or

(v) other comparable rights that are prescribed by rule by the exchange and that are designed to protect dissenting limited partners;

(B) the right not to have their voting power unfairly reduced or abridged;

(C) the right not to bear an unfair portion of the costs of a proposed limited partnership rollup transaction that is rejected; and

(D) restrictions on the conversion of contingent interests or fees into non- contingent interests or

fees and restrictions on the receipt of a non-contingent equity interest in exchange for fees for services which have not yet been provided.

As used in this paragraph, the term "dissenting limited partner" means a person who, on the date on which soliciting material is mailed to investors, is a holder of a beneficial interest in a limited partnership that is the subject of a limited partnership rollup transaction, and who casts a vote against the transaction and complies with procedures established by the exchange, except that for purposes of an exchange or tender offer, such person shall file an objection in writing under the rules of the exchange during the period during which the offer is outstanding.

* * * *

§ 78s. Registration, responsibilities, an oversight of self-regulatory organizations (Section 19)

* * *

(d) Notice of disciplinary action taken by self-regulatory organization against a member or participant; review of action by appropriate regulatory agency; procedure.

(1) If any self-regulatory organization imposes any final disciplinary sanction on any member thereof or participant therein, denies membership or participation to any applicant, or prohibits or

limits any person in respect to access to services offered by such organization or member thereof or if any self-regulatory organization (other than a registered clearing agency) imposes any final disciplinary sanction on any person associated with a member or bars any person from becoming associated with a member, the self-regulatory organization shall promptly file notice thereof with the appropriate regulatory agency for the self-regulatory organization and (if other than the appropriate regulatory agency for the self-regulatory organization) the appropriate regulatory agency for such member, participant, applicant, or other person. The notice shall be in such form and contain such information as the appropriate regulatory agency for the self-regulatory organization, by rule, may prescribe as necessary or appropriate in furtherance of the purposes of this chapter.

(2) Any action with respect to which a self-regulatory organization is required by paragraph (1) of this subsection to file notice shall be subject to review by the appropriate regulatory agency for such member, participant, applicant, or other person, on its own motion, or upon application by any person aggrieved thereby filed within thirty days after the date such notice was filed with such appropriate regulatory agency and received by such aggrieved person, or within such longer period as such appropriate regulatory agency may determine. Application to such appropriate

regulatory agency for review, or the institution of review by such appropriate regulatory agency on its own motion, shall not operate as a stay of such action unless such appropriate regulatory agency otherwise orders, summarily or after notice and opportunity for hearing on the question of a stay (which hearing may consist solely of the submission of affidavits or presentation of oral arguments). Each appropriate regulatory agency shall establish for appropriate cases an expedited procedure for consideration and determination of the question of a stay.

* * *

(g) Compliance with rules and regulations.

(1) Every self-regulatory organization shall comply with the provisions of this chapter, the rules and regulations thereunder, and its own rules, and (subject to the provisions of section 78q(d) of this title, paragraph (2) of this subsection, and the rules thereunder) absent reasonable justification or excuse enforce compliance —

(A) in the case of a national securities exchange, with such provisions by its members and persons associated with its members;

(B) in the case of a registered securities association, with such provisions and

the provisions of the rules of the Municipal Securities Rulemaking Board by its members and persons associated with its members; and

(C) in the case of a registered clearing agency, with its own rules by its participants.

(2) The Commission, by rule, consistent with the public interest, the protection of investors, and the other purposes of this chapter, may relieve any self-regulatory organization of any responsibility under this chapter to enforce compliance with any specified provision of this chapter or the rules or regulations thereunder by any member of such organization or person associated with such a member, or any class of such members or persons associated with a member.

* * * *

APPENDIX F — EXCERPTS FROM NEW YORK STOCK EXCHANGE, INC. CONSTITUTION

ARTICLE I, SECTION 3

DEFINITION OF TERMS

SEC. 3. *Definition of Terms.* Unless the context requires otherwise, the terms defined in this Section shall, for all purposes of this Constitution, have the meanings herein specified:

* * *

(i) The term "member corporation" means a corporation, registered as a broker or dealer in securities under, unless exempted by, the Act, approved by the Board as a member corporation, at least one of whose officers or employees is a member of the Exchange, or which has the status of a member corporation by virtue of permission given to it pursuant to the rules of the Exchange.

* * *

(k) The term "member organization" includes "member firm" and "member corporation".

* * * *

Appendix F

ARTICLE IV, SECTION 14

DELEGATION

SEC. 14. *Delegation.* The Board may delegate such of its powers as it may from time to time determine, subject to the provisions of this Constitution and applicable law, to such officers and employees of the Exchange, and to such committees, composed either of directors or otherwise, as the Board may from time to time authorize; provided, however, that a member, member organization, allied member or approved person affected by a decision of any officer, employee or committee acting under powers delegated by the Board may require a review by the Board of such decision, by filing with the Secretary of the Exchange a written demand therefor within 10 days after the decision has been rendered, except as otherwise provided in Article IX or the rules thereunder.